



# **Annual Report and Accounts**

Year ended 31 March 2007

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# Management Commentary

## AUDIT SCOTLAND ANNUAL REPORT 2006/07

### Statement from the Auditor General and Chair of the Audit Scotland Board

The Audit Scotland Corporate Plan for 2006-09 confirmed our three priorities:

- Supporting effective democratic scrutiny
- Maximising the value of the Audit
- Building an efficient and effective organisation

We are pleased to introduce Audit Scotland's annual report for 2006/07. The report highlights the full range of our work this year and gives an insight into the breadth and depth of our activities across public services. We remain committed to delivering our twin aims of holding public bodies to account and helping them improve.

This past year has once again seen Audit Scotland make a significant contribution to major public policy discussions. As the single audit agency for Scotland's public services, we are uniquely placed to consider not just individual organisations and sectors, but whole systems of public service delivery. Our position allows us to follow the public pound from policy formulation, right through to service delivery on the ground.

Audit Scotland supports public bodies to continue to improve, while providing assurance to elected representatives, appointed board members and the public that public money is being spent properly, efficiently and effectively. Some areas of our work are more visible than others, but our work with audited bodies remains the foundation of our business and of the assurance provided to audited bodies and other stakeholders.

Public audit in Scotland is delivered by Audit Scotland and private accountancy firms. We continue to believe that this mixed market model of delivery provides good value for money and ensures that the public audit regime benefits from the best audit resources in the country. In 2006 we successfully completed the smooth transition to new audit appointments across the public sector.

Public services continue to face significant challenges in Scotland. In the context of a tightening budgetary environment, all public services, including Audit Scotland, need to ensure they are delivering best value. In the past year we have been able to reduce our proposed increases in audit fees for most public bodies, return around £500,000 to audited bodies and make savings as a result of restructuring the business. We remain committed to improving the efficiency of public audit in Scotland.

# Management Commentary

## What we do

Audit Scotland exists to:

- provide services to the Auditor General and Accounts Commission
- promote high standards of governance, stewardship and management in public bodies
- deliver high quality public audit
- support service improvement and best value
- report in the public interest.

Audit Scotland helps the Auditor General and the Accounts Commission ensure that public money in Scotland is used properly, efficiently and effectively. Our aim is to hold public bodies to account and help them improve. We audit of the majority of devolved public services in Scotland which gives us a unique insight into the issues facing Scotland's public sector managers, appointed board members and elected representatives.

We carry out a wide variety of audits, including detailed and systematic investigations of various aspects of how public bodies work. We audit about 200 public bodies in Scotland which spend more than £29 billion a year. Audit Scotland delivers approximately two thirds, by value, of public audit in Scotland and we work in partnership with private firms, appointed by the Auditor General and Accounts Commission, to deliver the rest.

Our audit regime checks whether public bodies:

- manage their finances to the highest standards
- achieve best value in the use of public resources.

Three principles guide our work; our auditors are independent of the organisations they audit, they report in public, and they audit financial statements, governance and performance. Audit Scotland also helps ensure organisations:

- operate within the regulations that govern their work
- deliver value for money
- act honestly, with propriety and integrity

## Highlights of 2006/07

1. Delivered the annual audit of around 200 public bodies and £29 billion in Scotland, providing assurance to elected representatives, appointed board members and the people of Scotland.
2. Delivered, on behalf of the Accounts Commission, nine Best Value audits.
3. Completed a study into public sector pensions, reporting cumulative unfunded liabilities of between £43 billion and £53 billion.
4. Delivered a report on the Efficient Government initiative, recognising progress was being made in delivering efficiencies, but that more needs to be done to provide assurance on the accuracy of reported savings.
5. Reported on the implementation of the 21<sup>st</sup> Century Teacher's Agreement, an agreement which cost £2.15 billion to implement. We recommended that the Executive needs to work with partners to identify and report on a set of comprehensive performance measures.
6. Worked in partnership with the Audit Commission on the National Fraud Initiative, identifying £15 million of fraud and errors which could be eliminated.
7. Ensured a smooth transition to new audit portfolios, following the new five year audit appointments.
8. Reduced our proposed fee increases to most audited bodies and returned £500,000 to audited bodies

# Management Commentary

## Supporting effective democratic scrutiny

Our work helps elected representatives assess and scrutinise the performance of public services and ensure that public money is being spent appropriately. At a local level we provide assurance on the use of public money, performance and governance within individual public bodies. Our work is designed to hold those bodies to account and to help them improve. Our auditors attend audit committee meetings, making an important contribution to the overall scrutiny function in councils, health boards and central government bodies. Elected members can be assured that our work is independent and based on evidence. We also report in public which provides greater transparency for the accountability process in public bodies.

At a national level, we report on significant issues for the public services in Scotland. Reporting to either the Auditor General or Accounts Commission, our reports highlight issues that are relevant to whole sectors such as local government and health and, increasingly, across government. Audit Scotland's position as the single audit agency for the public sector in Scotland means we are uniquely placed to consider and comment on issues that span traditional organisational boundaries. This is becoming increasingly important as the shape of public service delivery continues to evolve.

Our work often makes a significant contribution to debates on important areas of public policy. For example, our reports on Community Planning, the Efficient Government initiative and public sector pension schemes have all made important contributions to the debates concerning how these should develop in future, based on independent, evidence based audit assessments.

## Reports

The following reports were published during the year:

- 195 final annual audit reports to public bodies
- 4 across government performance reports
- 4 central government performance reports
- 4 NHS performance reports
- 9 Best Value reports
- 4 other local government performance reports  
(including one Performance Indicators compendium and one Performance Indicators profiles report)
- 9 reports on accounts to the Scottish Parliament  
(Section 22 reports – Auditor General reports raising issues arising from annual audits of public bodies under his responsibility)
- 11 other publications  
(including Health and Community Care Bulletin, How the NHS Works: Governance in Community Health Partnerships Self Assessment Tool, Audit Scotland Corporate Plans for 2006/09 and 2007/10, Code of Audit Practice, Quick Guide to the Auditor General, Accounts Commission and Audit Scotland, Audit Scotland Annual Report 2005/06, Accounts Commission Annual Report 2005/06, Audit Scotland disability equality scheme and the Accounts Commission disability equality scheme).

## Management Commentary

Details of the above reports can be found in Appendix Three (page 23) and they can be found on our website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

### The good work we find

During the course of our audits, we find many examples of good practice and achievement at the bodies we examine. Reporting in public allows us to share this knowledge with the rest of the public sector. Among those we reported in 2006/07 were the following:

- Fire authorities throughout Scotland have cut incidents of arson and deliberate false alarms through a variety of community safety projects. The Tayside force worked with police to carry out joint patrols in an area of high risk in Dundee, cutting fire-raising incidents by 46 per cent in the scheme's first year. Strathclyde cut malicious fire alarms in East Renfrewshire and East Ayrshire by 40 per cent between 2005 and 2006 through work with the areas' anti-social behaviour working groups. Grampian officers delivered community safety education and advice and worked with community groups in two high risk Aberdeen neighbourhoods. This helped cut dwelling fires by 7.5 per cent and casualties by 71 per cent between 2004/05 and 2005/06 (*A review of service reform in Scottish fire and rescue authorities*, 1 March 2007).
- The admission of new nations to the European Union in 2004 has resulted in increasing numbers of migrant workers in the Scottish Borders. The Scottish Borders Council set up a migrant outreach worker role to help new residents settle and access services. The council created welcome packs with information on council services, housing, medical and health services, translation and benefits services. It is also working with the local housing association to address the issue of affordable housing (*Scottish Borders Council; The audit of Best Value and community planning*, 7 March 2007).
- Air quality assessments found several areas of Glasgow had unacceptable concentrations of nitrogen dioxide (NO<sub>2</sub>), so the city council created an Air Quality Management Area. This set in place several measures to reduce traffic numbers and congestion, as more than 70 per cent of the NO<sub>2</sub> was attributed to road traffic emissions. Subsequent monitoring has found that NO<sub>2</sub> levels have fallen (*Scottish Executive: an overview of the performance of transport in Scotland*, 28 September 2006).
- NHS Tayside set up a programme to implement NHS Quality Improvement Scotland standards on food, fluid and nutritional care in hospitals. A dietician and catering advisor produced more than 600 recipes that were each nutritionally analysed. Every kitchen in NHS Tayside then tested the recipes and gave feedback for any changes. A final set of recipes is due to be implemented by the end of 2007 (*Catering for patients; A follow-up report*, 30 November 2006.).

### Public performance reports

The reports we produce are presented in four groups:

- central government reports
- health and community care reports
- local government reports
- across government reports.

Our public reporting programme covers key areas of public interest and public policy. We develop our forward work programme after extensive consultation with stakeholders, audited bodies and the public in order to target areas where we can support improvement in public services.

## Management Commentary

Reports on the central government sector and the health and community care sector are prepared for the Auditor General. He then presents them to the Scottish Parliament's Audit Committee. Reports on local government are prepared for the Accounts Commission.

As public services are increasingly delivered across traditional sector boundaries, many of our reports cover more than one sector. Typically these will include local government, so we prepare these across-government reports for both the Auditor General and the Accounts Commission.

Many of our reports in 2006/07 highlighted the need for public sector bodies to develop more rigorous approaches to performance monitoring and reporting and to focus more on outputs and outcomes. At the moment it can be difficult to find robust evidence that particular policy initiatives or developments are actually delivering best value.

Full details of all our reports published in 2006/07 are in Appendix Three (pages 23 - 27).

### **Performance Information**

The Accounts Commission discharges its responsibility for performance information in local government through a national Direction. Audit Scotland is responsible for the development, publication and management of the statutory performance indicators (SPIs) on behalf of the Commission. The SPI Data Compendium (the Compendium) and Council Profiles are available on our web site by December each year. This allows our stakeholders to use the data for assessing performance and benchmarking progress.

The Compendium provides all the SPI data for Scotland's councils, fire brigades and police forces. The Council Profiles give individual profile reports on Scotland's councils, with details of their performance against a range of indicators, and reports comparing councils on a range of key services.

We integrate commentary on a number of key findings from the Compendium into the Local Authority Overview Report. Findings from the SPIs are also used in our Best Value audits and national studies.

The Commission is currently engaged in discussions with stakeholders on the future framework for performance monitoring in Local Government and the role of SPIs within that. We expect the initial results of these discussions to feed into the 2007 Direction.

### **Reports accompanying audited accounts to Parliament**

Auditor General reports, made under Section 22 of the Public Finance and Accountability (Scotland) Act 2000, raise issues arising from the annual audits of public bodies under his responsibility. Nine Section 22 reports were presented to Parliament in 2006/07. Details of these are in Appendix Three (pages 23 - 27).

### **Correspondence and complaints**

In 2006/07, Audit Scotland received 527 items of correspondence raising issues about the organisations that we audit, a rise of 180 per cent on 2005/06. This included 104 items relating to East Lothian Council and 180 in relation to Glasgow Housing Association. These items used proformas and required a standard response.

The nature and complexity of complaints varied widely. In examining them, Audit Scotland focused on whether audited bodies had incurred expenditure in accordance with their statutory powers, and whether they had taken steps to deliver financial probity and make best use of resources. We investigate further when we assess that there may be an audit issue.

## Management Commentary

Audit Scotland met its target of acknowledging correspondence within ten working days in 97 per cent of cases; and in 90 per cent of cases we met our target of providing a full response within one month of the date of acknowledgement. This compares with 95 per cent and 86 per cent respectively in 2005/06.

### **International work**

Audit Scotland continues to be involved in international activities, supporting developing countries in improving their own public audit arrangements. Much of our work in the international arena is conducted in partnership with other audit agencies, particularly the National Audit Office.

In 2006/07 we hosted several visits from overseas delegations. Visitors were keen to hear about the public audit model in Scotland, which is of particular interest to countries which are developing their own public audit arrangements. These visits allow us to learn from other countries and at times challenge our own thinking and assumptions. In the past 12 months we have welcomed visitors from:

- Sweden
- Japan
- The United States
- Uganda
- Malawi
- Tanzania
- China
- Russia
- Mongolia

In addition, Audit Scotland staff have been involved in capacity building projects overseas. As well as providing invaluable support to the recipient country, this international work provides an excellent development opportunity for our staff. In the past year, we have provided subject matter experts to projects in Lithuania and Uganda and several others are planned for 2007/08.

We are also involved in the Scotland Malawi Partnership Governance Forum which exists to raise the profile of and support governance issues in Malawi.



# Management Commentary

## Delivering the audit

The annual audit of public sector bodies continues to be the foundation of our work. It is this audit work that provides assurance to local elected representatives and board members and supports improvement in public organisations. It also informs much of our national performance work. The work is conducted according to the Code of Audit Practice which reflects the ever changing international standards for the quality of audit. It is therefore important that we continually strive to improve the way we conduct the audit, ensuring our clients and stakeholders gain maximum value from the audit process.

In 2005 we revised our approach to local audit work and have now delivered the new approach to health clients for two years and to local authorities for one full year. The approach ensures that the audit focuses on the key priorities and risks in public bodies, so that resources are directed at the issues that really matter to elected representatives, the public and managers. Feedback from clients continues to be positive and we were able to close the audits of 2005/06 accounts around one month earlier than in previous years.

While we will continue to improve our approaches to audit, we believe the current audit approach, with a clear focus on priorities and risks and based on a sound understanding of the business, will stand us in good stead for several years to come.

## Commissioning the Audit

In May 2006 the Auditor General and the Accounts Commission completed the procurement process for the new five year audit appointments. Approximately one third, by value, of the public audits in Scotland are conducted by private sector firms, with the remaining two thirds conducted by Audit Scotland.

The procurement was designed in part to develop greater collaborative working between private firms and Audit Scotland in order to deliver greater value to clients and stakeholders. All auditors involved in the audit of particular sectors meet regularly to share experiences, keep up to date with policy developments and discuss technical auditing matters. The transition to the new audit portfolios has been managed successfully and the 2006/07 audits are now underway. A full list of appointed auditors is available on our website at [www.audit-scotland.gov.uk/audit/appointments](http://www.audit-scotland.gov.uk/audit/appointments).

## UK and international standards setting

Audit Scotland contributes to the development of accounting and auditing standards in the UK through membership of a number of bodies including the Financial Reporting Advisory Board, the CIPFA/LASAAC Joint Committee and the Auditing Practices Board Public Sector Sub-Committee. Audit Scotland staff participate in many other panels and working groups that produce detailed guidance for public sector bodies. Reflecting the increasing importance of global standards to the UK public sector, we also contribute to the international auditing standard setting process through the work of the INTOSAI Expert Reference Panel and by responding to drafts of relevant standards.

Audit Scotland's Technical Services Unit provides technical advice and guidance for all public sector auditors in Scotland, ensuring they are aware of important developments in audit and accountancy and playing a key role in sustaining the high quality of public audit.

## Reporting arrangements

For the 2005/06 audits, 195 final annual audits were completed. Of these, 114 were delivered by Audit Scotland and 81 by private accountancy firms.

## Management Commentary

Auditors report to the Auditor General and the Accounts Commission. In some cases their work results in requests for further reports on specific issues, or the audits may be used as the basis of wider overviews of entire sectors. Auditors also report directly to the public bodies they audit, enabling them to identify problems and plan improvements themselves. In 2006/07 Audit Scotland's auditors produced 375 separate reports for the public bodies they audit. These management reports cover a wide range of areas, for example:

- financial management and budgetary control
- e-procurement
- asset management
- financial strategy and planning.

Overall, the standard of financial stewardship in Scotland remains sound. There were two qualifications to the accounts of local authorities at the Comhairle nan Eilean Siar and Shetland Islands Council. In both cases the qualifications were due to technical accounting issues. The Shetland Islands Council also breached European Commission rules on state funding of private businesses. There were no qualifications in the previous year. There were no reports to the Accounts Commission as a result of illegality, loss or impropriety in the way a local authority conducted its financial affairs.

Breakdown of audits:

• Central government	64
• NHS	24
• Further education	39
• Councils	32
• Joint boards	35
• Water sector	1
• Total	195

### Delivering quality

We remain committed to delivering a public audit service that is valued by clients, stakeholders and the general public. To do this, we need to ensure quality in everything we do. Our Audit Strategy Group is responsible for setting the standards expected of all public sector auditors in Scotland, as set out in the Code of Audit Practice. The Audit Strategy Group undertakes quality appraisals of audits, both those delivered by Audit Scotland and those delivered by external firms. All auditors appraised in 2006/07 obtained a satisfactory assessment.

In 2006/07 we conducted a service quality survey as part of our audit quality appraisal framework. We survey a different sector each year. The survey, which achieved a 65% return, was conducted on the NHS 2005/06 audits. 87% of clients rated the overall quality of service as good or very good.

Our performance audits follow a rigorous project methodology which ensures quality at every stage in the development process, from project scoping to reporting and follow up. In 2006 we further improved our quality assurance process which ensures that our performance audit work benefits from robust external quality assurance.

## Management Commentary

### National Fraud Initiative

The National Fraud Initiative (NFI) is a data matching exercise, delivered in partnership with the Audit Commission, which compares information mainly about benefit applicants, employees and public sector pensioners. NFI helps to identify fraud and error in the public sector.

Having completed the bulk of the work in 2005/06, in May 2006 we published *No hiding place*, our first report on the NFI in Scotland. Local authorities and the Scottish Public Pension Agency identified over £15m of overpayments and savings from the 2004/05 NFI. Cumulative savings have now reached around £27m in Scotland.

The 2006/07 NFI began in October 2006 and extended the exercise to include Scottish health bodies. Councils have also been required to provide a wider range of information than before and this should help them, for example, to recover higher levels of former tenants' arrears. NFI 2006/07 also allows councils to provide a much wider range of information relating, for example, to 'blue badges' and care home residents. In these cases NFI helps councils to check whether services are being used or charged after individuals have died. Councils provide this information for the audit where they consider there are benefits to be gained or risks addressed.

Public bodies are currently investigating their 2006/07 'matches' and auditors are monitoring their progress. We will publish a report on the 2006/07 NFI results in spring 2008.

# Management Commentary

## Improving the business

In 2006/07 we continued our efforts to make Audit Scotland a more efficient and effective organisation. We have been making changes to the way we run our business. Our commitment to continuous improvement is illustrated by developments in the way we manage our people, processes and technologies.

We continued to roll out our management development programme and we have implemented a new time recording system. Other projects include developing our information management, improved internal and external communications and an environmental management strategy. We carry out internal best value reviews and seek feedback from inside and outside the organisation on our performance.

## Efficiency, effectiveness and best value

Audit Scotland is committed to delivering an efficient and effective public audit service, ensuring best value in everything we do. This involves a commitment to continuous improvement and to maximising the value that clients and stakeholders receive from the audit process.

For the 2006/07 audit year we have been able to reduce our proposed increases in charges to most audited bodies from a projected 5 per cent to between 1 and 1.5 per cent. In addition we returned a further £500,000 to audited bodies.

We were able to introduce these rebates as a result of a revised VAT arrangement with Her Majesty's Revenues and Customs, combined with reductions in superannuation contributions and a surplus from previous years. The revised VAT arrangements resulted in £800,000 being returned to local authorities and a reduction in total costs by £400,000 per year.

Our overall budget increased by three per cent although some of our costs, such as fees to approved auditors (the firms), have increased by four per cent to reflect the impact of adopting International Standards. Audit Scotland is meeting the new standards at no additional cost, resulting in savings in charges to audited bodies of £139,000.

During 2006/07 we removed a senior post from the establishment, resulting in recurring annual savings of £160,000 per year.

The cost of NHS audits overall was reduced by £75,000 arising from the dissolution of NHS Argyll & Clyde. In NHS audits, the final element of cost reduction arising from the abolition of trusts was in place for 2006/07 audits, meaning that the total recurring annual savings are £264,000.

The largest part of our income comes from charges to audited bodies. We benchmark our charging regime using information from the Audit Commission and the National Audit Office and intelligence on audit firms' fees. An economy, efficiency and effectiveness study by our external auditors, H W Chartered Accountants, concluded that:

- our fee levels compare favourably against the audit fees charged for similar-sized authorities in England
- our running costs (or indirect costs), as a proportion of the total fee charged, has in overall terms fallen since 2004/05.

In 2006/07 we conducted internal best value reviews on programme and project management, our printing services and our correspondence and complaints handling. We have also been reviewing how best value audits in local government are conducted.

## Management Commentary

### Developing people

Audit Scotland employs around 280 people in offices in Aberdeen, East Kilbride, Edinburgh and Inverness. We work to ensure that our people are effective, confident and able to deliver for our clients and stakeholders. Our Personal Development Scheme (PDS) is now fully embedded which means that all members of staff benefit from at least one formal appraisal meeting each year with their manager.

During the past twelve months we have delivered on our 2006/07 Learning & Development strategy. We remain committed to professional and personal development for all staff, based on their performance appraisal with their managers. We support a range of personal effectiveness training, such as presentation skills, writing for impact and performance management. In addition, we support the use of coaching and mentoring as useful tools in the overall learning and development framework.

2006/07 also saw the continuation of our leadership development programme and the launch of our management development programme, which together are providing high quality personal development for senior staff. We have delivered technical and professional training through a mix of in-house and external specialists so our people maintain and enhance their professional knowledge. Our professional training scheme for auditors is accredited by CIPFA and four of our trainees achieved prize-winning results in their examinations during 2006, the best performance since Audit Scotland launched the scheme in 2001.

### Developing technology

In 2006/07 we continued to develop new systems and focused on getting the most from of our existing technologies. For example, we:

- developed a new time recording system which will allow us to monitor and report more accurately on time and cost information (the system went live on the 1<sup>st</sup> April 2007)
- implemented a new telephony system which will improve the service for external and internal callers and keep call costs down
- implemented a new finance system which allows us to manage and report on our financial resources more effectively
- developed a new intranet which will facilitate improved information and knowledge sharing
- connected new audit sites to the Audit Scotland network, allowing auditors to work more effectively on client site.

### Sustainability

Audit Scotland is committed to the principle of sustainability. We have an environmental management team which has set targets and nominated a number of environmental guardians throughout the organisation.

We try to reduce the impact of our work on the environment and have developed an environmental strategy that focuses on key areas where Audit Scotland has its biggest environmental impact. During 2006/07 we reduced our impact on the environment by:

- reducing the number of taxi journeys taken by staff
- reducing our use of paper
- using sustainable/fair trade products for meetings
- promoting environmentally friendly ways for employees to get to work and travel on business.
- reusing over 1000 items of stationery after a stationery amnesty
- taking steps to reduce our energy use.

## Management Commentary

In addition we recycled our waste paper and plastic and our publications use a minimum of 80% recycled paper. Audit Scotland has and will continue to raise awareness of environmental issues with staff through our network of environmental guardians.

### Diversity

During 2006/07, work to mainstream diversity and equalities across Audit Scotland continued with a range of presentations to teams and the acquisition of an e-learning package. We produced an action plan to take forward our work on diversity and equality and we will be continuing to implement this over coming months. The plan incorporates our responsibilities in relation to race, disability and gender equality in the public sector. In December 2006 we published our Disability Equality Scheme and action plan and we are currently developing our gender equalities scheme.

### Freedom of Information

We recognise the value of openness and transparency and we are mindful of the potential public interest in the information we hold.

We keep a log of information requests that are less straightforward to deal with and have a formal process, agreed by Audit Scotland's Board, for how to treat such enquiries. In 2006/07, we logged 13 such Freedom of Information requests, details of which can be found on our website at [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk). In addition, a wide range of information is available through our publication scheme, details of which can also be found on our website.

### Our impact

In 2006/07 our local auditors attended around 330 audit committee meetings of the bodies they audit and provided those bodies with at least 375 separate written reports through the year. We are therefore a local presence to support accountability and effective governance within public sector bodies.

Our work also supports improvement in the development and delivery of public services. The impact of our work can be seen in different ways, depending on the nature of the topic and the organisations involved.

For example, our *Catering for patients* report was published in November 2006 after which Health Facilities Scotland asked for the data we collected in the course of the study to help it implement our recommendations. Our follow-up report on *Planning ward nursing* was published in January 2007 and highlighted how the Scottish Executive and NHS boards are addressing the recommendations made in our 2002 baseline report through the NHS's Nursing and Midwifery Workload and Workforce Planning Project. This project aims to improve the planning of the ward nursing workforce.

We proactively publish the results of our work and it is widely reported by the media. All of our reports are published on our website and in 2006/07 46,700 copies of our reports and 3,711 podcasts were downloaded.

During 2006/07 we continued to measure the impact of our work. The following are just two examples of the ongoing impact of our publications.

## Management Commentary

### *Delayed discharges*

In 2005, we published *Moving on? An overview of delayed discharges in Scotland*, which took a whole systems approach to the issues surrounding delayed discharges, when a patient has to stay in hospital longer than necessary. This meant we looked across organisational boundaries when considering all the issues involved in delayed discharges.

The report made several recommendations to the Scottish Executive, NHS boards and councils. In August 2006 we looked at how some of our recommendations are being implemented and found:

- the Executive has changed the way it sets targets to make them fairer
- boards and councils are placing a greater emphasis on taking a ‘whole systems’ approach
- boards and councils are adopting a wide range of delayed discharge initiatives
- such initiatives are being better evaluated, in line with our recommendations.

### *Maintaining Scotland’s roads*

While our 2004 *Maintaining Scotland’s roads* report resulted in extensive media coverage, we reviewed it in 2006 to assess the impact it had. We found:

- the Executive had pledged another £60million per year for three years to help councils tackle a road maintenance backlog
- the Society of Chief Officers in Transportation Scotland (SCOTS) produced their own follow-up study based on Audit Scotland’s audit of road maintenance
- SCOTS has bid for funding to create a national asset management framework
- 26 out of Scotland’s 32 councils have cited the report as a catalyst for change in their road maintenance policies and procedures.

### **Sharing our knowledge with others**

We seek to increase the impact of our work by contributing to external bodies and forums where we share the knowledge and expertise gathered during the course of our work. In 2006/07, Audit Scotland staff presented to more than 60 external seminars, conferences and training events and served on around 50 external working groups. These ranged from a Social Work Inspection Agency event to a Chartered Institute of Housing conference on complaint handling, to a Services for Children working party. We remain committed to making the most of what we know and do and will continue to find new ways to share our experience more widely.

In 2006/07 two Audit Scotland colleagues held senior positions in the Chartered Institute of Public Finance and Accountancy (CIPFA). Caroline Gardner, the Deputy Auditor General, was CIPFA President from May 2006, while Lynn Bradley, Director of Audit, was Chair of CIPFA in Scotland. Our Director of Audit Strategy, Russell Frith, sits on several accounting policy and standards bodies, including the Treasury Steering Group on Government Accounting and the Financial Reporting Advisory Board.

Our involvement in external bodies and forums provides the opportunity for us to listen to the experiences of those managing, delivering and using public services. This helps us continue to focus on the issues that really matter to public services in Scotland.



# Management Commentary

## Who we are

### Audit Scotland Board

Audit Scotland's work is overseen by a board which meets around six times a year to consider plans and strategic direction. The board is chaired by Alastair MacNish.

The board comprises:

**Alastair MacNish**

Chair, Accounts Commission

**Robert W Black**

Auditor General and Accountable Officer

**Phil Taylor**

Independent non-executive member

**John Baillie**

Member of Accounts Commission

**Caroline Gardner**

Deputy Auditor General and Controller of Audit

### Governance and accountability to Parliament

Audit Scotland is held to account through statutory arrangements put in place by the Scotland Act 1998 and through the Public Finance and Accountability (Scotland) Act 2000. The Scottish Commission for Public Audit (SCPA) is central to these arrangements. The SCPA meets in public. It scrutinises our budget and annual report and accounts and appoints our external auditor, currently H W Chartered Accountants.

Audit Scotland's work is overseen by its board. The board has an Audit Committee which appoints our internal auditors and receives our annual accounts and internal audit reports. Our internal auditor for 2006/07 was Chiene and Tait.

The board also has a remuneration committee which sets and reviews the salaries of senior staff (excluding the Auditor General for Scotland whose salary is set by the Parliamentary Corporate Body) and the main terms and conditions for all staff.

Neither our internal or external auditors have any other professional relationships with us.

### The Audit Scotland Management Team

**Robert W Black**

Auditor General for Scotland and Accountable Officer

**Caroline Gardner**

Deputy Auditor General and Controller of Audit

Caroline manages the Audit Services Group and the Public Reporting Group.



## Management Commentary

The Audit Services Group carries out the audits of public sector bodies in Scotland. Caroline works with the audit services directors to support high standards of governance and accountability in public services, and to encourage performance improvements.

The Public Reporting Group carries out performance studies of public services and audits of Best Value in councils. They also produce overview reports on health, local government and central government policy areas, and investigate issues of public concern.

### **Russell Frith**

Director of Audit Strategy

Russell is responsible for audit procurement, fees and income, auditing and accounting standards, technical support and quality assurance.

### **Diane McGiffen**

Director of Corporate Services

Diane manages the corporate development of Audit Scotland. She leads on business planning and performance reporting and heads up the following services: human resources and organisation development, information services, finance, facilities management, and communications.

**Bill Magee** is Secretary to both the Accounts Commission and the Audit Scotland Board, and is also responsible for legal and procedural advice.

### **Our sector teams**

#### **Local government**

Director of Public Reporting **David Pia** reports on themes and issues within local authorities, police boards and fire boards. David's team also produces overview reports, performance studies and Best Value audits of local government.

Director of Audit Services **Lynn Bradley** manages the in-house audit service we provide to local authorities, police boards and fire boards, examining their individual performance. Her work includes financial statements, governance and performance management matters.

#### **Health and central government**

Director of Public Reporting **Barbara Hurst** is responsible for investigating issues of public concern, and producing overview reports and performance studies across the health and central government sectors.

Director of Audit Services **Gavin Stevenson\*** is responsible for the in-house audit services we provide to the health and central government sectors, including the audit of financial statements, governance and performance management.

\* Gavin Stevenson left Audit Scotland in May 2007

# Management Commentary

## Financial summary

### A summary of income and expenditure

The task of auditing Scotland's public bodies has expanded greatly since 2000. In 2006/07, Audit Scotland spent £25 million on services for the Auditor General and the Accounts Commission: this is less than 0.1% of the £29 billion spent by the bodies that are audited. The majority of these costs are recovered through charges to these organisations with the balance received as direct funding from the Scottish Parliament.

Audit Scotland is required to produce accounts for each financial year detailing the resources acquired, held or disposed of during the year and the way in which they were used. The Auditor General has been appointed as Accountable Officer and is responsible for the preparation of these accounts.

Audit Scotland's accounts are independently audited on behalf of the Scottish Commission for Public Audit (SPCA), which appointed H W Chartered Accountants to carry out the audit.

The following section provides a summary of selected items from the accounts. The full accounts in full are published on pages 31 to 55 and are available on our website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

### 2006/07 Financial Results

In 2006/07 income earned from audited bodies and miscellaneous income was £18,862k. Expenditure in the same period was £24,918 with the resulting Net Operating costs totaling £6,056k. These costs which were met from direct funding received from the Scottish Parliament were £2,416k less than the agreed budget of £8,472k.

Of the £2,416k above, £875k related to accounting benefits arising from compliance with Financial Reporting Standard 17 on Pensions and a further £480k was in respect of funding that was planned to be used in 2007/08. The balance was mainly attributable to reduced employer superannuation payments and lower expenditure on external consultancy support.

Income levels in 2006/07 were £720k less than the previous year. The reduction was mainly attributable to fee rebates made to audited bodies (£500k) and changes in the timing of audit work following changes in audit portfolios arising from the procurement and appointment process undertaken during 2006/07.

Expenditure in 2006/07 was £640k higher than in the previous year. Continuing investment in training and development of our staff together with increased recruitment costs were the main contributors to this increase.

During the year revised VAT arrangements in respect of Local Government audits were agreed with HM Revenue and Customs that allowed Audit Scotland to recover input VAT backdated to 2004. The recoveries relating to periods prior to 1<sup>st</sup> April 2006 have been treated as a prior year adjustment in this years accounts. As a result information for 2005/06 in the following tables has been restated.

## Management Commentary

### Sources of income

Most income is from charges to audited bodies and can be broken down as shown in the table below

### Analysis of expenditure

In 2006/07, 77 per cent of expenditure was spent on staff and fees to auditors. This compares with 79 percent in the previous year.

Income	2006/07		2005/06 (restated)	
	£000	% total	£000	% total
Fees paid by local authorities	11,425	61	12,792	65
Fees paid by health bodies	4,067	22	4,402	22
Fees paid by water bodies	230	1	169	1
Fees paid by further education colleges	600	3	553	3
Fees paid by Scottish Executive & sponsored bodies	1,591	8	1,590	8
Bank interest	147	1	145	1
Miscellaneous	248	1	190	1
Other finance income (pensions)*	554	3	(259)	-1
<b>Total</b>	<b>18,862</b>	<b>100</b>	<b>19,582</b>	<b>100</b>

\* Other finance income is comprised of income from expected return on the local government pension scheme assets less the interest payable on the scheme liabilities

Other revenue funding	2006/07		2005/06	
	Required £000	Available £000	Required £000	Available £000
Direct Funding from Parliament	6,056	8,472	4,696	6,474

Expenditure	2006/07		2005/06 (restated)	
	£000	% total	£000	% total
Staff and members' costs	13,599	55	13,586	56
Fees and expenses paid to appointed auditors	5,605	22	5,515	23
Buildings, rent and depreciation	1,782	7	1,770	7
Operating costs	3,932	16	3,407	14
<b>Total</b>	<b>24,918</b>	<b>100</b>	<b>24,278</b>	<b>100</b>

# Management Commentary

## Appendix One: Audit Scotland’s performance indicators

### Supporting effective democratic scrutiny

<p>Number of performance audit reports published, including Best Value and Statutory Performance Indicator reports</p>	<p>25 reports were published in 2006/07 (26 in 2005/06).</p>
<p>Response times for correspondence from members of the public concerning potential audit issues</p>	<p>In 2006/07, 527 items of correspondence were received. This figure included 104 items about East Lothian Council and 180 items about the Glasgow Housing Association.</p> <p>97% of correspondence was acknowledged on time (95% 2005/06) and 90% was responded to in full within one month of being acknowledged (86% in 2005/06).</p> <p>After stripping out the 284 items of correspondence concerning the two organisations above this still shows a 30% increase in correspondence on 2005/06.</p>

### Maximising the value of Audit

<p>Percentage of audits delivered against statutory or Accounts Commission timescale for each sector</p>	<p>99% of audits were completed on time (98% in 2005/06).</p> <table data-bbox="646 1332 1173 1541"> <thead> <tr> <th>By sector:</th> <th>2006/07</th> <th>2005/06</th> </tr> </thead> <tbody> <tr> <td>Health</td> <td>100%</td> <td>100%</td> </tr> <tr> <td>Central government</td> <td>100%</td> <td>100%</td> </tr> <tr> <td>Further education</td> <td>100%</td> <td>100%</td> </tr> <tr> <td>Local authorities</td> <td>97%*</td> <td>97%</td> </tr> <tr> <td>Other LA audits</td> <td>100%</td> <td>94%</td> </tr> </tbody> </table> <p>* The 3% shortfall represents only one council.</p>	By sector:	2006/07	2005/06	Health	100%	100%	Central government	100%	100%	Further education	100%	100%	Local authorities	97%*	97%	Other LA audits	100%	94%
By sector:	2006/07	2005/06																	
Health	100%	100%																	
Central government	100%	100%																	
Further education	100%	100%																	
Local authorities	97%*	97%																	
Other LA audits	100%	94%																	
<p>Percentage of audit plans submitted and fees agreed within specified timescale</p>	<p>96% of audit plans submitted to Audit Scotland within specified timescales (89% for 2005/06).</p> <p>56% of fees agreed within specified timescales (60% for 2005/06).</p>																		
<p>Results of quality appraisal scheme</p>	<p>Six auditors were selected for a full quality appraisal visit and one was subject to a desk-based review. The conclusions were that the overall standard of work was satisfactory.</p>																		

# Management Commentary

## Appendix One: Audit Scotland's performance indicators (continued)

### Building and effective and efficient organization

<p>Percentage of invoices paid within 30 days</p>	<p>We set a more challenging target for the payment of invoices in 2006/07. The target was to pay invoices within 30 days of the invoice date. We achieved 84% within the target time.</p> <p>Using previous methods of measurement our achievement would have been 93% for 2006/07 (96% in 2005/06).</p>
<p>Sickness absence</p>	<p>Sickness levels were, on average, 5 days per employee (compared with 4 days in 2005/06). This compares favourably with the average days lost per employee/annum in public services of 9.9 days*.</p> <p>*Source: CIPD Absence Management Survey July 2006</p>
<p>Staff turnover</p>	<p>Staff turnover for 2006/07 was 8.5% (2.2% 2005/06).</p>

# Management Commentary

## Appendix Two - Where we fit in

### Audit Scotland

Audit Scotland exists to provide services to the Auditor General for Scotland and the Accounts Commission, allowing them in turn to provide assurance to the Scottish Parliament and Ministers that public money is being spent appropriately.

Auditors report the detailed findings of audits directly to the bodies they audit. In 2006/07 we produced 195 final audit reports, which set out in detail the findings, conclusions and recommendations of the auditor. All of our reports are made public. For more detail on this, turn to page 7 (Delivering the audit). Final audit reports are based on evidence and provide an opinion on public bodies' financial statements, performance and governance arrangements.

Audit Scotland also produces overview reports showing how different sectors perform during each financial year. We have recently extended our overview reporting to cover major policy areas, such as transport. In 2006/07 we published sector overviews of the NHS and local authorities.

We also produce reports that look at performance and value for money, either in an individual organisation or across a sector or sectors. For more information on our performance reports, turn to Appendix Three (pages 23 - 27), Audit Scotland's Public Performance Reports.

### The Auditor General for Scotland

The Auditor General for Scotland (AGS) is a Crown appointment, made on the recommendation of the Scottish Parliament. It is an independent position and not subject to the control of the Scottish Executive or the Scottish Parliament.

The AGS is responsible for the audit of the Scottish Executive and most other public sector bodies, except for local authorities and fire and police boards. He also performs the Comptroller function in Scotland, which involves him formally approving the release of funds from Westminster to the Scottish Executive.

The AGS reports to the Scottish Parliament on the proper, efficient and effective use of public funds. With the support of Audit Scotland he also delivers a programme of performance audits to Parliament, after consultation with Parliament and other stakeholders.

### The accountability process for reports to the AGS

The Auditor General can report to Parliament under sections 22 and 23 of the Public Finance and Accountability Act (Scotland) 2000. After Audit Scotland prepares such a report for the Auditor General, he presents that report to Parliament and it is published.

The Audit Committee of the Scottish Parliament can then hold evidence sessions to explore the issues detailed in the Auditor General's report. Typically, the Committee will question senior officials, including the relevant accountable officer, and can call ministers to give evidence.

Having taken evidence, the Audit Committee publishes its own report, with detailed recommendations aimed at ensuring lessons are learned. Where appropriate, the Scottish Executive responds to the Audit Committee report by publishing its response and action plan for each recommendation.

Other committees of the Scottish Parliament can and have used Audit Scotland reports in their work.

# Management Commentary

## The Accounts Commission

Accounts Commission members are appointed by Scottish Ministers following a public appointments process. The Commission is independent of local authorities and of the Scottish government. The Accounts Commission publishes its own annual report which is available at [www.audit-scotland.gov.uk/accounts](http://www.audit-scotland.gov.uk/accounts).

The Commission is responsible for the audit of all local authorities and associated bodies (such as fire and police boards). It also supports improvement in local government and ensures Councils are achieving best value. Each year, the Commission publishes information on how Councils are performing against a number of indicators, which allows elected members and the public to compare performance within and across Councils.

The Commission can make recommendations and reports to ministers. The Commission also has powers to take action against councillors and council officials if they break the law or if their negligence or misconduct leads to money being lost.

## The accountability process for reports to the Accounts Commission

Local government reports, including Best Value audits, are prepared by Audit Scotland under the direction of the Deputy Auditor General, who acts as the Controller of Audit. Reports are presented to the Accounts Commission and published.

Having received a report from the Controller of Audit, the Accounts Commission can:

- report and make recommendations to the organisation being scrutinised
- hold a hearing
- report and make recommendations to Scottish Ministers.

## Working with scrutiny partners

Audit and inspection bodies must work effectively together to minimise the burden of scrutiny and maximise the value gained from all of our work. An independent audit function is a key element of the accountability framework in public services and helps maintain trust in public services, public servants and elected representatives.

Audit Scotland and other bodies put a significant amount of effort into working together to streamline our scrutiny of public services. We have agreed ways of working with our scrutiny partners, such as NHS Quality Improvement Scotland (NHS QIS), and the Scottish Public Services Ombudsman. These agreements set out each body's powers and responsibilities and arrangements for joining up audit and review in public bodies where it is appropriate to do so.

We also have a track record of joint work with inspectorates and other bodies, such as joint inspections of education authorities with HM Inspectorate of Education (HMIE), and joint studies with HMIE, HM Inspectorate of Constabulary, and NHS QIS.

Where possible, we also seek to reduce the scrutiny burden on public bodies and avoid duplication of effort by sharing data. For instance, in 2006/07 our report *Catering for patients* used NHS QIS data on screening patients for risk of under nutrition.

## Management Commentary

Audit Scotland is in regular contact with the other public audit agencies in the UK, the National Audit Office, the Audit Commission, the Wales Audit Office and the Northern Ireland Audit Office. Audit Scotland takes a full part in the Public Audit Forum (PAF), a body formed by the agencies in the four UK nations and the Republic of Ireland to provide a focus for developing public audit, making public audit more efficient and effective, advising on common technical problems and sharing good practice.

During 2006/07, the Scottish Executive commissioned an independent review, led by Professor Lorne Crerar, of the country's scrutiny bodies. The review is looking at the arrangements for delivering audit, inspection, regulation and complaints handling in Scotland. Audit Scotland welcomes the review and has given evidence and support to it. The review is due to report in the summer of 2007.



# Management Commentary

## **Appendix Three: Audit Scotland's public performance reports**

In 2006/07 we published the following reports:

### **Central Government (reports for the Auditor General)**

#### Relocation of Scottish Executive Departments, agencies and NDPBs -21/09/2006

This report found that 28 public sector bodies had been (or would be) either relocated out of or established outside Edinburgh under the Scottish Executive's relocation policy. In most cases, it was not clear whether relocation would deliver the wider policy objectives. Little had been done to evaluate the impact of the policy, so it was difficult to determine whether relocations represented good value for money.

#### Scottish Executive: an overview of the performance of transport in Scotland - 28/09/06

This was the first performance overview of a policy area. We reported that the Scottish Executive had performed well against most of its transport targets, but it needed to do more to provide a full picture of what was being achieved with the billions of pounds worth of investment going into transport. The report called for the Scottish Executive to improve its monitoring and reporting of what was being delivered.

#### Performance management in the Scottish Qualifications Authority - 09/11/06

The report highlighted the progress made by the Scottish Qualifications Authority since 2000, when problems in processing exam results led to incomplete and inaccurate results for 17,000 candidates. It found the SQA had successfully regained customer and stakeholder confidence. Its board and executives showed commitment and leadership in driving improvements and the authority had clear objectives.

#### The Efficient Government Initiative: a progress report - 19/12/2006

In September 2006 the Executive reported that it had achieved £442 million in efficiency gains in 2005/06. This review focused on twelve of the major efficiency projects with a view to determining whether robust systems were in place to record and report the claimed savings. The report found there was commitment to improve efficiency but the Executive needs to do more to provide assurance on the levels of savings and their impact on service delivery.

### **Health (reports for the Auditor General)**

#### Managing IT to deliver information in the NHS in Scotland - 23/11/06

The report recommended that the Scottish Executive continue to improve the way it manages information technology to support care in the NHS in Scotland. Doing this involves a major cultural shift for the NHS in Scotland and will take time. In the past there has been a range of locally-developed IT systems across Scotland and to get the most out of its investment, the NHS needs a clear national strategy. The Scottish Executive is working towards this.

#### Catering for patients: a follow-up report - 30/11/06

This report followed up on progress made since Audit Scotland last investigated hospital catering in 2003. It found hospital catering services were improving, with patients having more choice and the NHS getting better at responding to their preferences. But NHS boards need to focus more on making sure patients get the nutritional care they need.

## Management Commentary

### Overview of the financial performance of the NHS in Scotland - 14/12/06

This report looked at the financial performance of the NHS in Scotland in the financial year 2005/06 and the outlook for the future. It found that there were record levels of funding going into the health service and the NHS ended the year in surplus. However, the surplus was in capital budgets, not the day-to-day running of the health service, and strong long-term planning is needed as the service faced financial pressures.

### Planning ward nursing - legacy or design? A follow-up report - 25/01/07

Progress has been made towards improving the planning and management of ward nursing. Many of the recommendations made in an Audit Scotland report on ward nursing published in 2002 are being addressed. The NHS now needs to build on progress made and ensure it has the information needed to manage the workforce well. The use of bank and agency nurses also needs to be kept under review.

### **Local government (reports for the Accounts Commission)**

#### **The Audit of Best Value and Community Planning**

##### The Highland Council - 05/04/2006

Highland Council often delivered appropriate and effective solutions to residents' problems. But there were areas in which it must make improvements if it is to be in a position to deliver Best Value. In particular there was a need for stronger corporate direction.

##### Renfrewshire Council - 06/07/2006

Renfrewshire Council's leadership was strong and effective, understood what needed to be done to deliver Best Value and was making good progress with this. However there was still much to be done to improve service performance.

##### Comhairle nan Eilean Siar - 17/08/2006

This report on Comhairle nan Eilean Siar cited a number of areas where the comhairle must improve. These include failing to plan for and to introduce Best Value processes and a lack of robust performance management arrangements. The report said the comhairle had strong community engagement, active and committed political leadership and effective financial stewardship, and faced particular geographical and historical problems.

##### East Ayrshire Council - 06/09/2006

This report found East Ayrshire Council was committed to best value. It had effective leadership, performed well in a number of activities and could recognise areas for improvement and address them. The council needed to streamline its best value processes and ensure continuous improvement throughout its activities.

##### West Dunbartonshire Council - 11/10/2006

This report found the council had made limited progress in Best Value and urgently needed to address its weaknesses. Its leadership was not respected and there was a lack of transparency in decision-making. Staff morale was poor, and there were allegations of bullying. The Accounts Commission called a public hearing on the basis of this report.

## Management Commentary

### Shetland Islands Council – Progress report 18/01/07

Shetland Islands Council had made a start in addressing the issues raised in the Accounts Commission findings of March 2005. But the commission remained concerned at the pace and extent of change in delivering improvements.

### Inverclyde Council – Progress report 20/02/07

The Commission said that Inverclyde Council was moving in the right direction, following its critical report in 2005 and that there was a clear commitment and enthusiasm to improve. Among the actions it had taken was to appoint a new chief executive, set up a new management structure and new political management arrangements, and appoint a corporate management team.

### City of Edinburgh Council - 27/02/07

The City of Edinburgh Council displayed many of the features of a Best Value council, including many examples of good service delivery. However some services, such as refuse collection and the processing of planning applications still needed to improve.

### Scottish Borders Council - 07/03/07

This report said Scottish Borders Council had made substantial progress in recent years and had done much of the groundwork needed to achieve Best Value. However there remains a gap between its ambitions and its current performance.

## **Other Local Government**

### Overview of the local authority audits 2006 - 15/02/07

The Accounts Commission welcomed a general picture of improved performance by Scotland's local authorities, but it warned that major challenges lay ahead. The Commission pointed to possible changes following the local government elections in May 2007 and substantial financial pressures.

### A review of service reform in Scottish fire and rescue authorities - 01/03/07

This report said Scottish fire and rescue authorities were giving more emphasis to fire prevention and community safety, but it was too early to demonstrate a sustained reduction in risks from fire. New procedures had delivered efficiency savings and freed up staff for community fire safety activities. Authorities needed to do more to evaluate the impact of their community safety work to ensure they were making best use of resources.

## **Across government reports (joint reports for the Auditor General and the Accounts Commission)**

### A mid-term report: a first stage review of the cost and implementation of the teachers' agreement - 11/05/2006

The Teachers' Agreement brought benefits for the teaching profession, but the lack of performance measures made it difficult to assess the wider impact of the £2.15 billion investment. The report recommended that the Executive work with other parties to the Agreement to identify and report on a set of comprehensive performance measures.

## Management Commentary

### No hiding place: the National Fraud Initiative in Scotland - 17/05/2006

Audit Scotland facilitated a national detection exercise under which Scotland's councils worked with other public bodies to identify £15m worth of fraud and errors. As a result, the bodies could now seek to recover about £6m and prevent about £9m in ongoing and future pension overpayments.

### Community planning: an initial review - 16/06/2006

Community planning partnerships have made progress but need to do more to show how their work is improving public services. The report also found that the complex remit of many partnerships made it difficult for them to achieve their aims, and called on the Executive to support community planning more effectively.

### Public sector pension schemes in Scotland - 20/06/2006

This report on the six main public sector pension schemes in Scotland found that the gap between current funding and the potential liability could be as high as £53 billion. The contributions from both employees and employers would almost certainly increase and there were likely to be demands on future public spending to meet these costs.

## Other documents

### Health and community care bulletin - 30/05/2006

This was the first issue of a bulletin aimed at helping non-executive board members and elected representatives in their role of holding health boards to account and helping them to improve. It set out the national performance audit work done in the NHS and community care sector over the previous year and the key issues arising from that.

### How the NHS works: Governance in Community Health Partnerships - Self Assessment Tool: Issues for non-executive board members 22/08/2006

Audit Scotland published a self-assessment tool aimed at supporting NHS Boards and Community Health Partnerships (CHPs) develop and review the governance arrangements in CHPs. This document was to support that tool. It identified issues and questions for non-executive board members to consider about governance in CHPs and to assess themselves against.

## Reports accompanying audited accounts to Parliament (Section 22 Reports)

### **Scottish Enterprise**

Scottish Enterprise overspent by £33m against its budget of £454 million in 2005/06.

### **Scottish Prison Service**

The prison service has included a provision of £58m for its possible liability for compensation and other costs for cases brought by prisoners over prison conditions. It also has a contingent liability of £27m for other cases that may arise in connection with potential human rights breaches.

### **Argyll and Clyde Health Board**

The board was dissolved at the end of the 2005/06 year, and the Scottish Executive cleared its £81.7m cumulative deficit. Its successor boards, Highland and Greater Glasgow, inherited an underlying £28.4m recurring deficit.

## Management Commentary

### **Highland Health Board**

The auditor's report was qualified due to a difference of view concerning the board's accounting treatment of two private finance initiative (PFI) contracts.

### **Western Isles Health Board**

The board incurred a deficit of £1.75m in 2005/06, putting its cumulative debt at £2.48m. The auditor also highlighted issues with the board's governance arrangements.

### **Lanarkshire Health Board**

In 2005/06 the board made savings of £11.6m on its revenue budget. But due to its previous deficit, its cumulative debt was £8.39m at the end of the financial year.

### **Scottish Fisheries Protection Agency**

Scottish Executive ministers cancelled the procurement of a new fishing boat after expert opinion considered the SFPA had breached EU procurement rules. There was a risk that unsuccessful tenderers could take legal action and the contract could have been cancelled.

### **Inverness College**

The college incurred a deficit of £667,000 in the year to 31 July 2006, increasing its cumulative debt to £3.48m.

### **James Watt College**

The auditor questioned the college's ability to continue as a going concern after it incurred £3.87m deficit in the year to 31 July 2006.

# Remuneration Report

## Remuneration Committee

The remuneration of senior managers is determined by Audit Scotland's Remuneration Committee. The membership and remit of the Committee are set out in Standing Orders as follows:

The Remuneration Committee will consist of a member or members of the Board who are not employees of Audit Scotland. The Board may appoint persons who are not members of the Board to be members of or advisers to the Remuneration Committee, and may pay them such remuneration and expenses as the Board decides.

The purposes of the Remuneration Committee are

To keep under review and make recommendations to the Board on

- Arrangements for the fixing of levels of remuneration and conditions of service for all employees of Audit Scotland
- General adjustments to remuneration and conditions of service affecting all employees
- Fixing of annual salary and other conditions of service of the Deputy Auditor General, the Managing Director of Audit Services (until October 2006), Secretary, Directors and Assistant Directors

The members of the Remuneration Committee during the year were:

- Chairman – P Taylor
- Member – A MacNish
- Member – J Baillie
- Member – R Black

In setting salary levels the Remuneration Committee has regard to the following considerations:

- the need to recruit, retain and motivate suitably able and qualified people to exercise their different responsibilities
- regional/local variations in labour markets and their effects on the recruitment and retention of staff
- Government policies for improving the public services including the requirement to meet the output targets for the delivery of services
- the funds available subject to any expenditure limits
- Other relevant Government policies or targets

The Committee takes account of the evidence it receives about wider economic considerations and the affordability of its recommendations.

# Remuneration Report

## Audit Scotland Board

Under the provisions of schedule 2 of the Public Finance and Accountability (Scotland) 2000 Act the Auditor General, the Chairman of the Accounts Commission and any employee of Audit Scotland or member of the Accounts Commission are not entitled to any remuneration in respect of their membership of the Audit Scotland Board. The remuneration of the independent member of the Board fell within the band £5,000 to £10,000.

## Senior Management

The salaries paid (including any overtime and bonus payable, but excluding employer's superannuation and national insurance contributions), pension entitlements (including the annual increase in real terms) and benefits in kind of the most senior managers of Audit Scotland during the year ended 31 March 2007 were in the bands shown as follows:

		<b>R Black</b>	<b>C Gardner</b>	<b>H Hall</b>	<b>R Frith</b>	<b>D McGiffen</b>
		<i>Auditor General</i>	<i>Depute Auditor General</i>	<i>Managing Director of Audit Services</i>	<i>Director of Audit Strategy</i>	<i>Director of Corporate Services</i>
<b>Salary</b> <i>Note(i)</i>	2006~07 <b>£000</b>	135 - 140	120 - 125	70 - 75	85 - 90	85 - 90
	2005~06 <b>£000</b>	130 - 135	115 - 120	115 - 120 <i>Note (iv)</i>	85 - 90	85 - 90
<b>Estimated value of benefits in kind</b> <i>Note (ii)</i>	2006~07 <b>£</b>	-	-	-	-	3,600
	2005~06 <b>£</b>	-	-	-	-	3,300
<b>Real increase in value of accrued pension</b>	<b>£000</b>	0 - 2.5	0 - 2.5	Note (iv)	0 - 2.5	0 - 2.5
<b>Value of total accrued pension as at 31 March 2007</b>	<b>£000</b>	30 - 35	25 - 30	Note (iv)	10 - 15	15 - 20
<b>Lump Sum</b>	<b>£000</b>	See Note 3c	85 - 90	Note (iv)	40 - 45	45 - 50
<b>Cash equivalent transfer value (CETV) as at 31 March 2006</b>	<b>£000</b>	See Note 3c	333	538	217	174
<b>Cash equivalent transfer value (CETV) as at 31 March 2007</b>	<b>£000</b>	See Note 3c	371	Note (iv)	236	198
<b>Real increase in CETV</b> <i>Note (iii)</i>	<b>£000</b>	-	34	Note (iv)	17	21

### Notes

- (i) Salary, for those joining or leaving the Management Team, relates to the amounts earned from the date of joining or to the date of leaving.
- (ii) The estimated value of benefits in kind relates to the provision of vehicles. Values to the nearest £100.
- (iii) This is calculated after adjustment for inflation and changes in market investment factors.
- (iv) Left Audit Scotland October 2006

# Remuneration Report

## Senior Management (continued)

Further information on the pensions payable to Audit Scotland staff, including the senior management, can be found in Audit Scotland's Annual Accounts (see Note 3).

## Service Contracts

Unless otherwise stated below the senior managers hold appointments which are open-ended until they reach normal retirement age. Early termination, other than through misconduct, would result in the individual receiving compensation.

The Auditor General for Scotland is not an employee of Audit Scotland but is a Crown appointment following nomination by Parliament. His salary is determined by the Scottish Parliamentary Corporate Body.

## Accounts Commission

Members of the Accounts Commission are not employed by Audit Scotland and a detail of their remuneration is not required under the policy outlined in the Financial Reporting Manual. The following information is included for information and to assist the reader of the report.

The average number of Members of the Commission throughout the period was 12 and their remuneration was as follows:

	<b>Remuneration Banding</b>
	<i>£000</i>
Chairman - Mr A MacNish	25-30
Depute Chair	10-15
Commission Members	0-10

**R W Black**  
Auditor General  
Accountable Officer

22 June 2007



## Foreword to the Accounts

### **Statutory Background**

Audit Scotland was formed on 1 February 2000 (and commenced operations on 1 April 2000), following the transfer of staff and property from the Accounts Commission and National Audit Office, under the Public Finance and Accountability (Scotland) Act 2000. Part 2 of the Public Finance and Accountability (Scotland) Act 2000 established Audit Scotland as a corporate body.

### **Basis of Accounts**

These are the accounts of Audit Scotland for the year ended 31 March 2007. The accounts have been prepared in compliance with a direction given by the Scottish Ministers in accordance with section 19(4) of the Public Finance and Accountability (Scotland) Act 2000.

### **Sources of Funding**

Audit Scotland may, under Part 2 of the Public Finance and Accountability (Scotland) Act 2000, make reasonable charges to audited bodies in respect of the exercise of its functions. Audit Scotland must seek to ensure that, taking one year with another, its charges for certain types of work are broadly equivalent to its expenditure. Any expenditure not met from charges is payable out of the Scottish Consolidated Fund.

### **Post Balance Sheet Events**

There were no important events occurring after the year-end which fall under the definition of a post balance sheet event.

### **Pensions and Early Departure Costs**

Details about the organisation's pension and early retirement costs are included in the notes to these accounts.

### **Board and Management**

Details of the Board and Management Team are in the Management Commentary and the Remuneration Report.

### **Staff Relations and Equal Opportunities**

Audit Scotland is committed to ensuring that recruitment and management of employees is carried out on merit on the basis of equal opportunity for all. Full and fair consideration is given to applications for employment from disabled persons where they have the skills and abilities to perform the job. Audit Scotland has a race equality scheme and a disability equality scheme.

Audit Scotland recognises the importance of good industrial relations and effective communication with all its staff. Regular meetings are held with staff representatives to discuss matters of mutual interest.

### **Payment to Suppliers**

In line with CBI Prompt Payment Code Audit Scotland has a policy to pay all invoices not in dispute in 30 days or the agreed contractual terms if otherwise specified: 84% of all invoices for the year were paid on or before the due date.

## Foreword to the Accounts

### **Auditors**

Accounts prepared by Audit Scotland must, under section 19 of the Public Finance and Accountability (Scotland) Act 2000, be sent to the Scottish Commission for Public Audit (SCPA) for auditing. The SCPA appointed H W Chartered Accountants, as auditors to Audit Scotland for a three-year period commencing March 2006.

So far as I am aware, there is no relevant audit information of which Audit Scotland's auditors are unaware, and I have taken all the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that Audit Scotland's auditors are aware of that information.

***R W Black***

Auditor General  
Accountable Officer

22 June 2007

# Statement of Accountable Officer's Responsibilities

Under section 19(4) of the Public Finance and Accountability (Scotland) Act 2000 Audit Scotland is required to prepare resource accounts for each financial year, in conformity with the direction of the Scottish Ministers, detailing the resources acquired, held, or disposed of during the year and the use of resources by Audit Scotland during the year.

The resource accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of Audit Scotland, the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year.

The Scottish Commission for Public Audit has appointed the Auditor General for Scotland as Accountable Officer for Audit Scotland with responsibility for preparing the accounts of Audit Scotland and for submitting them for audit to the Scottish Commission for Public Audit.

In preparing the accounts the Accountable Officer is required to comply with the Financial Reporting Manual (FReM) and in particular to:

- observe the accounts direction including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the FReM, have been followed; and disclose and explain any material departures in the accounts;
- prepare accounts on a going concern basis.

The responsibilities of the Accountable Officer, including responsibility for the propriety and regularity of the public finances for which an Accountable Officer is answerable, for keeping proper records and for safeguarding assets, are set out in the "Accountable Officer's Memorandum".

## Statement on The System of Internal Control

This statement is given in respect of the resource account for Audit Scotland. As Accountable Officer I have responsibility for maintaining a sound system of internal control which supports the achievement of Audit Scotland's policies, aims and objectives whilst safeguarding public funds and Audit Scotland's assets for which I am personally responsible, in accordance with the responsibilities as set out in the "Accountable Officer's Memorandum".

The system of internal control is designed to manage rather than eliminate the risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. No significant weaknesses have been identified.

The system of internal control is based on a continuing process designed to identify the principal risks to the achievement of Audit Scotland's policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them effectively and economically. This process was in place throughout the year to 31 March 2007 and up to the date of approval of the annual report and accounts.

As Accountable Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. Audit Scotland has established the following processes:

- a Board that meets regularly to consider the plans and strategic direction of Audit Scotland (the Board comprises the Auditor General, the Chairman of the Accounts Commission, The Deputy Auditor General and two non-executive members);
- an audit committee and a remuneration committee;
- a corporate risk strategy, and a risk register that is reviewed every six months;
- Chiene and Tait were appointed internal auditors in October 2001 and report independently on the adequacy and effectiveness of Audit Scotland's system of internal control together with recommendations for improvement. Their internal audit plan is constructed on a risk-based approach;
- regular reports from managers on the steps they are taking to manage risks in their areas of responsibility including progress reports on key projects;
- facilitated workshops for risk awareness training and to identify the risks facing the organisation;
- establishment and development of key performance and risk indicators;

My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and of executive managers within Audit Scotland who have responsibility for the development and maintenance of the internal control framework, and by comments made by the external auditors in their management letter and other reports.

**R W Black**  
Accountable Officer

22 June 2007

*Schedule 1*  
**Summary of Resource Outturn**  
**Year ended 31 March 2007**

	<i>2007 Estimate £000</i>	<b>2007 Actual £000</b>	<b>2006 Actual £000</b>
<b>Net Total Costs</b>	<b>(8,472)</b>	<b>(6,056)</b>	<b>(4,696)</b>
<b>Net Cash Requirement</b> ( <i>see below</i> )		<b>6,904</b>	<b>7,932</b>
<b>Reconciliation of resources to Net Cash Requirement</b>			
	Note	<b>2007 £000</b>	<b>2006 £000</b>
Net Operating Cost ( <i>Schedule 2</i> )		6,056	4,696
Capital: Purchase of fixed assets	7	990	142
		<b>7,046</b>	<b>4,838</b>
<b>Adjustments</b>			
Non cash items:			
- Depreciation	4	(255)	(361)
- Notional interest on capital	4	(20)	16
- Pension scheme - net revenue charge		960	728
- Movement in net pension liabilities		4,867	(11,083)
Opening net debtors/creditors		(1,700)	11,640
Closing net debtors/creditors		(5,660)	1,700
Creditor due to Consolidated Fund	9	1,666	454
		<b>(142)</b>	<b>3,094</b>
<b>Net Cash Requirement</b> ( <i>Schedule 4</i> )		<b>6,904</b>	<b>7,932</b>

*Schedule 2*  
**Operating Cost Statement**  
**Year ended 31 March 2007**

	Note	<b>2007</b> £000	<b>Restated</b> <b>2006</b> £000
<b>Administration Costs</b>			
Staff costs	2	(13,599)	(13,586)
Other administration costs	4	(11,319)	(10,692)
<b>Gross administration costs</b>		<b>(24,918)</b>	<b>(24,278)</b>
Operating income	5	18,308	19,841
Other finance income	6	554	(259)
<b>NET OPERATING COST</b>		<b>(6,056)</b>	<b>(4,696)</b>

**Statement of recognised gains and losses (SRGL)**

	Note	<b>2007</b> £000	<b>2006</b> £000
<b>Actuarial gain/(loss) recognised</b>			
Actual return less expected return on pension scheme assets		257	6,095
Experience gains/(losses) arising on pension scheme liabilities		(1)	1,479
Changes in financial assumptions underlying the present value of the pension scheme liabilities		(6,082)	2,798
<b>Total (losses)/gains recognised since last annual report</b>	3	<b>(5,826)</b>	<b>10,372</b>

*Schedule 3*  
**Balance Sheet**  
**As at 31 March 2007**

	Note	2007 £000	Restated 2006 £000
<b>Fixed Assets</b>			
Tangible assets	7	1,285	550
<b>Current Assets</b>			
Debtors	8	3,142	7,688
Cash at bank and in hand		1,666	454
		<b>4,808</b>	<b>8,142</b>
<b>Creditors</b>			
Amounts falling due within one year	9	<b>4,293</b>	<b>6,783</b>
<b>Net Current Assets/(Liabilities)</b>		<b>515</b>	<b>1,359</b>
<b>Total assets less current liabilities</b>		<b>1,800</b>	<b>1,909</b>
Deferred liabilities	10	(34)	(64)
Provision for early retirement	11	(1,787)	(1,320)
Net funded pension (liability)/asset	3	(2,687)	2,180
<b>NET (LIABILITIES)/ASSETS</b>		<b>(2,708)</b>	<b>2,705</b>
<i>Represented by:</i>			
<b>TAXPAYERS' EQUITY</b>			
Net funded pension (liability)/asset	3	(2,687)	2,180
General Fund	12	(21)	525
	16	<b>(2,708)</b>	<b>2,705</b>

**R W Black**  
Auditor General  
Accountable Officer

22 June 2007

*Schedule 4*  
**Cash Flow Statement**  
**Year ended 31 March 2007**

<b>Cash Flow Statement</b>	<b>Note</b>	<b>2007</b> £000	<b>Restated</b> <b>2006</b> £000
Net cash outflow from operating activities	(note a)	(6,154)	(7,814)
Capital expenditure and financial investment	(note b)	(750)	(118)
Financing from the Consolidated Fund (supply)	(note c)	8,116	8,058
<b>Increase/(Decrease) in cash in the period</b>		<b>1,212</b>	<b>126</b>

*Notes to the Cash Flow Statement*

		<b>2007</b> £000	<b>Restated</b> <b>2006</b> £000
<b>a) Reconciliation of operating cost to operating cash flows</b>			
Net operating cost ( <i>Schedule 2</i> )		(6,056)	(4,696)
<i>Adjustment for non-cash items:</i>			
- Depreciation	7	255	361
- Notional interest on capital		20	(16)
- Pension scheme - net revenue (credit)/charge		(960)	(728)
Decrease/(Increase) in debtors		4,546	(6,211)
(Decrease)/Increase in creditors		(2,293)	3,930
Adjustment for cash balance due to Consolidated Fund	9	(1,666)	(454)
<b>Net cash outflow from operating activities</b>		<b>(6,154)</b>	<b>(7,814)</b>
<b>b) Capital expenditure and financial investment</b>			
Purchase of fixed assets	7	(990)	(142)
<i>less</i> movement in accrued expenditure		240	24
		<b>(750)</b>	<b>(118)</b>
<b>c) Analysis of financing</b>			
Opening Cash balance payable to the Consolidated Fund		454	328
From Consolidated Fund (Supply)		7,662	7,730
<b>Financing from the Consolidated Fund (supply)</b>		<b>8,116</b>	<b>8,058</b>
(Increase)/Decrease in cash		(1,212)	(126)
<b>Net cash requirement (<i>Schedule 1</i>)</b>		<b>6,904</b>	<b>7,932</b>



*Schedule 5*

**Resources by Departmental Aims and Objectives  
for the year ended 31 March 2007**

***Aim:*** *To provide high quality support to the Auditor General and the Accounts Commission*

<b>Net Operating Cost</b>	<b>Gross Expenditure £000</b>	<b>Income £000</b>	<b>Net Expenditure £000</b>
<b>2007 Actual</b>	<b>24,918</b>	<b>18,862</b>	<b>6,056</b>
<b>2006 Actual (Restated)</b>	<b>24,278</b>	<b>19,582</b>	<b>4,696</b>

# Annual Report and Accounts 2006-07

## Notes to the Accounts

### 1: Statement of Accounting Policies

The Accounts have been prepared in accordance with the accounts direction issued by Scottish Ministers under section 19(4) of the Public Finance and Accountability (Scotland) Act 2000 and also in accordance with the Financial Reporting Manual applicable for the year. The particular accounting policies adopted by Audit Scotland are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

#### *a) Basis of accounting*

The accounts have been prepared under the historical cost convention. In accordance with the principles of resource accounting, the gross funding received from the Scottish Consolidated Fund is recorded directly within the General Fund (note 12) and therefore is not included in the operating income received in the year in Schedule 2.

The Balance sheet at 31 March 2007 shows net liabilities of £2.7M. This reflects the inclusion of pension liabilities falling due in future years, which are to be financed by charges for audit work and funding from the Consolidated Fund. Such funding will be from grants of Supply approved annually by the Scottish Parliament, to meet Audit Scotland's Net Cash Requirement.

In common with similar public bodies, the future financing of Audit Scotland's liabilities will be met by future grants of Supply and the application of future income, both to be approved annually by the Scottish Parliament. The approval for amounts for 2007/08 has already been given and there is no reason to believe that future approvals will not be forthcoming. We have accordingly considered it appropriate to adopt a going concern basis for the preparation of these financial statements.

#### *b) Tangible fixed assets*

All property occupied by Audit Scotland is leasehold. The minimum level of capitalisation of a tangible fixed asset is £5,000 for individual or group purchases.

#### *c) Depreciation*

Depreciation has been provided at a rate calculated to write off cost in equal annual instalments over the estimated useful lives of assets. Asset lives are normally written off as follows:

<i>Leasehold premises</i>	<i>life of lease</i>
<i>Furniture and fittings</i>	<i>5 years</i>
<i>Computer equipment</i>	<i>3~4 years</i>

#### *d) Amortisation of rent-free periods*

Rent-free periods on leases of premises are amortised over the period of the lease, or over the period until the first break point in the lease whichever is the shorter.

#### *e) Operating income*

Operating income relates directly to the audit activities of Audit Scotland. It principally comprises fees and charges for services provided on a full cost basis to audited bodies.

# Annual Report and Accounts 2006-07

## Notes to the Accounts

### 1: Statement of Accounting Policies (continued)

#### *f) Work in Progress*

Work in Progress is valued on the basis of a proportion of the agreed fee earned by the Balance Sheet date less an allowance for any foreseen losses. Payments received on account of work in progress in excess of or below the value of carrying out the relevant work are included in creditors or debtors as appropriate.

#### *g) Cost of capital charge*

A non-cash capital charge, reflecting the cost of capital utilised by Audit Scotland, is included in the operating statement. The charge is calculated on the average value of fixed assets and working capital held during the year at the Government's standard interest rate of 3.5% per annum.

#### *h) Operating leases*

The total cost of operating leases is charged to revenue in equal instalments over the life of the lease.

#### *i) Value Added Tax*

Input tax in respect of Auditor fees and expenses incurred in the delivery of Local Authority Audits on behalf of the Accounts Commission are reclaimed from HMRC. All other input tax is charged to the Operating Cost Statement.

#### *j) Pension arrangements*

Audit Scotland has complied fully with the requirements of FRS 17 for the year ended 31 March 2007. Audit Scotland makes pension provision for present and former employees through three pension schemes. The Auditor General has benefits provided through a scheme by analogy to the Local Government Pension scheme. Employees joining Audit Scotland after 1 April 2000 and those transferring to Audit Scotland from the Accounts Commission have benefits provided through the Local Government scheme.

Employees transferring to Audit Scotland at 1 April 2000 from the NAO are covered by the provisions of the Principal Civil Service Pension Scheme.

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 2: Staff Costs and Numbers

Staff costs comprise:	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
<i>Administrative Staff</i>		
Salaries	10,536	10,647
National Insurance	920	922
Superannuation	1,602	1,873
Provision for early retirement costs	746	291
Adjustment for retirement benefit scheme costs ( <i>see below</i> )	(328)	(275)
	<b>13,476</b>	<b>13,458</b>
<i>Accounts Commission Members</i>		
Salaries	104	112
National Insurance	6	7
Travel and subsistence	13	9
	<b>123</b>	<b>128</b>
	<b>13,599</b>	<b>13,586</b>

The provision for early retirement costs includes the provision for pensions of the former Local Government Ombudsmen and their staff – see note 11.

The average number of directly employed staff during the period was 267 (2006 – 279). The average full time equivalent number for agency staff used during the period was 11 (2006 – 14).

<i>Analysis of local government retirement benefit scheme costs:</i>	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
Current service costs	1,776	1,749
Past service costs	(321)	13
Curtailement and settlements	-	11
	1,455	1,773
Less: Employees' contributions	(496)	(491)
<b>Charge to revenue</b>	<b>959</b>	<b>1,282</b>
Actual contributions	(1,287)	(1,557)
Adjustment for retirement benefit scheme costs	<b>(328)</b>	<b>(275)</b>

### 3: Pension assets and liabilities

In accordance with Financial Reporting Standard No 17 *Retirement benefits* (FRS 17) Audit Scotland is required to disclose certain information concerning assets, liabilities, income and expenditure related to pension schemes for its employees. Audit Scotland operates two main pension schemes; the Local Government Scheme, administered by the Lothian Pension Fund, and the Principal Civil Service Pension Scheme, or PCSPS. Audit Scotland is not required to record information related to the PCSPS scheme as the liability for payment of pension rests with the Scottish Executive. In addition, Audit Scotland operates a “by analogy” scheme outside the two main schemes.

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 3: Pension assets and liabilities (continued)

#### a) Local government scheme

Audit Scotland has an agreement with City of Edinburgh Council under which all staff are eligible to enter the Lothian Pension Fund (the name of the Local Government Superannuation Scheme managed by the Council) in accordance with its rules. It is a defined benefit scheme providing pension benefits and life assurance for all permanent staff.

The following valuations have been provided by Hymans Robertson, the independent actuaries to Lothian Pension Fund. The financial assumptions used for the purposes of their FRS 17 calculations as at 31 March 2007 were as follows:

	<b>2007</b>	<b>2006</b>
Price increases	3.2%	3.1%
Salary increases	4.7%	4.6%
Pension increases	3.2%	3.1%
Discount rate	5.4%	6.0%

Audit Scotland's estimated assets and liabilities in Lothian Pension Fund amounted to:

	<i>£000</i>	<i>£000</i>
Assets (see below)	43,359	39,140
Liabilities	(46,046)	(36,960)
<b>Net Funded Assets/(Liabilities)</b>	<b>(2,687)</b>	<b>2,180</b>
Unfunded liabilities – early retirement provision	(1,787)	(1,320)
<b>Net Funded Assets/(Liabilities)</b>	<b>(4,474)</b>	<b>860</b>

Assets are valued at fair value, principally market value for investments, and consist of:

	<b>Long Term Return at 31 March 2007</b>	<b>Assets at 31-Mar-07</b>	<b>Long Term Return at 31 March 2006</b>	<b>Assets at 31-Mar-06</b>
	<i>% per annum</i>	<i>£000</i>	<i>% per annum</i>	<i>£000</i>
Equities	7.8%	33,257	7.4%	32,070
Property	4.9%	2,348	5.5%	4,180
Bonds	5.8%	5,330	4.6%	2,310
Cash	4.9%	2,424	4.6%	580
<b>Estimated employer assets</b>	<b>7.2%</b>	<b>43,359</b>	<b>7.0%</b>	<b>39,140</b>
Total value of liabilities		(46,046)		(36,960)
<b>Net Pension Surplus/(Deficit)</b>		<b>(2,687)</b>		<b>2,180</b>

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 3: Pension assets and liabilities (continued)

Liabilities are valued on an actuarial basis using the projected unit method, which assesses the future liabilities of the fund discounted at their present value. The valuations are based on a valuation as of 31 March 2007 by Hymans Robertson.

The movement in the funded part of the net pension liability for the year to 31 March 2007 is as follows:

	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
<b>Opening net pensions liability at 1 April</b>	<b>2,180</b>	<b>(8,903)</b>
Current Service cost	(1,776)	(1,749)
Employer and employee contributions	1,783	2,824
Past service costs	321	(13)
Impact of settlements and curtailments	-	(158)
Net return on assets	631	(193)
Actuarial (losses)/gains	(5,826)	10,372
	<hr/>	<hr/>
<b>Closing Net Pension Assets/(Liabilities) at 31 March</b>	<b>(2,687)</b>	<b>2,180</b>

#### History of Experience Gains and Losses

	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Difference between the expected and actual return on assets	257	6,095	726	3,256
Value of assets	43,359	39,140	24,247	20,857
<b>Percentage of assets</b>	<b>0.6%</b>	<b>15.6%</b>	<b>3.0%</b>	<b>15.6%</b>
Experience gains/(losses) on funded liabilities	(1)	1,479	7	(30)
Total present value of liabilities	46,046	36,960	33,150	29,176
<b>Percentage of total present value of funded liabilities</b>	<b>0.0%</b>	<b>4.0%</b>	<b>0.0%</b>	<b>(0.1%)</b>
Actuarial (losses)/gains recognised in SRGL	(5,826)	10,372	23	1,369
Total present value of funded liabilities	46,046	36,960	33,150	29,176
<b>Percentage of total present value of funded liabilities</b>	<b>-12.7%</b>	<b>28.1%</b>	<b>0.1%</b>	<b>4.7%</b>

During the year ended 31 March 2007, Audit Scotland's contribution to the pension fund represented 15.8% (2006 – 18.9%) of contributing employees' pensionable pay. Under Superannuation Regulations contribution rates are set to meet 100% of the overall liabilities of the Fund. In their valuation as of December 2005, Hymans Robertson recommended employers' contributions of 15.8% for three years, commencing in 2006 – 07.

The significant movement from net assets to net liabilities in the local government scheme is primarily due to a decrease in the discount rate.

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### ***b) PCSP Scheme***

Employees of the NAO transferring to Audit Scotland on 1 April 2000 have pension benefits provided through the Principal Civil Service Pension Scheme (PCSPS). Audit Scotland makes payments of superannuation contributions to PCSPS at rates set by the Government Actuary.

The PCSPS is an unfunded multi-employer defined benefit scheme; however Audit Scotland is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 2003. Total liabilities at 31 March 2006 were estimated at £101.3 billion. Further details may be found in the separate scheme statement of the PCSPS ([www.civilservice-pensions.gov.uk](http://www.civilservice-pensions.gov.uk)).

During the year ended 31 March 2007, Audit Scotland paid an employer's contribution of £294k (2006 - £304k) into the PCSP scheme at rates between 17.1% and 25.5% of pensionable pay (2006 - 16.2% to 24.6%). Audit Scotland has been informed that contributions will remain at the 2006/07 rates in 2007/08. Employer contribution rates are reviewed every three years following a scheme valuation by the Government Actuary. The contribution rates reflect benefits as they are accrued, not when costs are actually incurred, and they reflect past experience of the scheme.

### ***c) By analogy scheme***

Mr R W Black has benefits provided by analogy to the Local Government pension scheme. Contributions are paid to the Scottish Consolidated Fund. During the year ended 31 March 2007, Audit Scotland paid an Employer's contribution of £21.5k (2006 - £30.8k) into this scheme. No information is available regarding cash equivalent transfer values or lump sum benefits.

### ***Early Departure Costs***

Certain costs arising from the early retirement of staff are payable by Audit Scotland. These relate mainly to the granting of compensatory added years and early payment of pensions, which employers must make to the pension fund.

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 4: Administration Costs

	£000	2007 £000	Restated 2006 £000
<b><i>Fees and Expenses to appointed audit firms:</i></b>			
Local authorities (Note 4a)	2,490		2,638
National Health Service	1,674		1,811
Water	239		167
Further education	511		427
Scottish Executive and sponsored bodies	691		472
		<b>5,605</b>	<b>5,515</b>
<b><i>Other Costs:</i></b>			
Rent and rates	1,020		945
Other accommodation costs	507		464
Travel and subsistence	838		851
Legal and other professional fees	784		813
Stationery and printing	359		375
Training	752		433
Staff recruitment	318		71
Communications (telephone, postage)	105		103
Insurance	125		172
Information technology	470		424
Internal Audit	29		22
External Audit - financial statements	19		33
External Audit - other work	37		-
Other	76		126
<i>Non-cash items:</i> Depreciation	255		361
Notional interest on capital	20		(16)
		<b>5,714</b>	<b>5,177</b>
		<b>11,319</b>	<b>10,692</b>

*Rent and rates includes £783k in respect of property leases (see note 13).*



# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 4a: Prior Year Adjustment - Value Added Tax

The VAT position of Audit Scotland altered during the year following discussion with HM Revenue and Customs. As a result Audit Scotland will recover VAT on Approved Auditor fees and expenses for Local Authorities audits. During the year input VAT from 1<sup>st</sup> November 2004 was recovered from HM Revenue and Customs. The recoveries relating to prior years were repaid to audit bodies. The amounts recovered from HM Revenue and Customs for 2004/05 and 2005/06 have been treated as a prior year adjustment. For 2004/05 the amount recovered was £175k and for 2005/06 was £437k. In the accounts the comparator figures for 2005/06 Income and Expenditure (Notes 4 & 5) have been reduced by £437k. Debtors and Creditor figures as at 31<sup>st</sup> March 2006 have been increased by £612k (Notes 8 & 9).

All VAT expense with the exception of that relating to Approved Auditor fees and expenses for Local Authority Audits is irrecoverable.

### 5: Operating Income

	<b>2007</b>	<b>Restated</b>
	<i>£000</i>	<i>£000</i>
<i>Fees and charges payable:</i>		
- by Local Authorities <span style="float: right;"><i>(Note 4a)</i></span>	11,425	12,792
- by National Health Service bodies in Scotland	4,067	4,402
- by Water bodies	230	169
- by Further Education Colleges	600	553
- by Scottish Executive and sponsored bodies	1,591	1,590
	<b>17,913</b>	<b>19,506</b>
Bank Interest	147	145
Miscellaneous Income	248	190
	<b>18,308</b>	<b>19,841</b>

### 6: Other finance income

	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
Expected return on local government pension scheme assets	2,871	1,803
Interest on pension scheme liabilities	(2,317)	(2,062)
	<b>554</b>	<b>(259)</b>

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 7: Fixed Assets

	<b>Leasehold premises</b>	<b>Furniture and fittings</b>	<b>Computer equipment</b>	<b>Total</b>
<i>Cost</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
At 1 April 2006	410	354	1,059	<b>1,823</b>
Additions	776	-	214	<b>990</b>
Disposals	(74)	(308)	-	<b>(382)</b>
<b>At 31 March 2007</b>	<b>1,112</b>	<b>46</b>	<b>1,273</b>	<b>2,431</b>
<i>Depreciation</i>				
At 1 April 2006	217	337	719	<b>1,273</b>
Charge for the year	41	9	205	<b>255</b>
Depreciation on Disposals	(74)	(308)	-	<b>(382)</b>
<b>At 31 March 2007</b>	<b>184</b>	<b>38</b>	<b>924</b>	<b>1,146</b>
<i>Net Book Value</i>				
<b>At 31 March 2007</b>	<b>928</b>	<b>8</b>	<b>349</b>	<b>1,285</b>
<b>At 31 March 2006</b>	<b>193</b>	<b>17</b>	<b>340</b>	<b>550</b>

Fixed assets are shown at historical cost. It is the opinion of Audit Scotland that inclusion of fixed assets at current costs would have no material effect upon the financial position of Audit Scotland.

All property leases are for periods of less than 50 years.

### 8: Debtors

		<b>2007</b>	<b>Restated 2006</b>
	<i>£000</i>	<i>£000</i>	<i>£000</i>
Trade debtors:			
other central government bodies	401		526
local authorities	235		4,095
NHS bodies	209		1,473
public corporations	-		63
bodies external to government	311		291
		1,156	6,448
Work in progress		1,364	100
VAT	( Note 4a)	184	612
Prepayments		438	528
		<b>3,142</b>	<b>7,688</b>

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 9: Creditors

	2007	Restated
	£000	2006
	£000	£000
<i>Amounts falling due within one year:</i>		
Trade creditors:		
Local Authorities	2	-
NHS bodies	-	10
Bodies external to government	<u>771</u>	<u>267</u>
	773	277
Cash balance payable to Consolidated fund	1666	454
Deferred income	517	5,036
Superannuation	388	175
Accruals <span style="float: right;"><i>(Note 4a)</i></span>	919	811
Rent free period on premises – current liability <i>(Note 10)</i>	30	30
	<u><b>4,293</b></u>	<u><b>6,783</b></u>

The cash balance payable to the Consolidated Fund is based on the accounting conventions adopted for resource-based supply.

### 10: Deferred Liabilities

Audit Scotland rents premises in various locations in accordance with its operational requirements. During the year ended 31 March 2003 various leases were negotiated with rent-free periods.

	2007	2006
	£000	£000
<b>Opening balance at 1 April:</b>		
Current	30	30
Deferred	<u>64</u>	<u>93</u>
	<b>94</b>	<b>123</b>
Additions	-	-
Released during year	(30)	(29)
	<u><b>64</b></u>	<u><b>94</b></u>
<b>Closing balance at 31 March</b>		
	<b>64</b>	<b>94</b>
<i>Whereof:</i>		
Current	30	30
Deferred	<u>34</u>	<u>64</u>
	<u><b>64</b></u>	<u><b>94</b></u>

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 11: Provision for early retirement

The provision represents the actuarially computed early retirement added years pensions, this being the estimated future liability of Audit Scotland. The movement during the year was as follows:

	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
<b>Opening balance at 1 April</b>	<b>1,320</b>	<b>1,164</b>
Additions	319	162
Utilised in year	(69)	(84)
Revaluation	217	78
<b>Closing balance at 31 March</b>	<b>1,787</b>	<b>1,320</b>

Prior to establishment of the Public Services Ombudsman's office Audit Scotland provided support services including payroll and finance for the Local Government Ombudsman. The related liabilities were assumed to transfer to the new Ombudsman following the enactment of the Scottish Public Services Ombudsman Act 2002. However following a review of the implementation of the Act it has been determined that the liability for pensions of former Local Government Ombudsmen and their staff did not transfer to the new Ombudsman's office. Accordingly at 31<sup>st</sup> March 2007 Audit Scotland has recognised the pension liability for staff previously employed by the Scottish Local Government Ombudsman. The liability as at 31<sup>st</sup> March 2007 was £319k.

### 12: General Fund

	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
<b>Opening balance at 1 April</b>	<b>525</b>	<b>(1,639)</b>
Opening Cash balance payable to the Consolidated Fund	454	328
Funding received from Consolidated Fund	7,662	7,730
Closing Cash balance payable to the Consolidated Fund	(1,666)	(454)
<b>Net funding from Scottish Parliament</b>	<b>6,450</b>	<b>7,604</b>
Net Operating Cost	(6,056)	(4,696)
Notional interest on capital	20	(16)
Transfer to net funded pension liabilities	(329)	(921)
Net return on assets	(631)	193
<b>Closing balance at 31 March</b>	<b>(21)</b>	<b>525</b>

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 13: Leases

During the period to 31 March 2007 the amounts charged to revenue in respect of operating leases for premises and equipment were as follows:

	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
Premises ( <i>Note 4</i> )	783	696
Equipment	427	431
	<b><u>1,210</u></b>	<b><u>1,127</u></b>

The amounts payable in the next financial year in respect of such leases are as follows:

<b>Lease expiry</b>	<b>2007</b>		<b>2006</b>	
	<b>Premises</b>	<b>Equipment</b>	<b>Premises</b>	<b>Equipment</b>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Within one year	5	55	5	45
In two to five years	169	296	-	323
After five years	523	-	692	-
	<b><u>697</u></b>	<b><u>351</u></b>	<b><u>697</u></b>	<b><u>368</u></b>

The amounts payable in the next financial year in respect of Premise leases noted above exclude any amounts that might fall due in respect of the rent reviews due in respect of 110 George Street, Edinburgh and Ballantyne House, Inverness.

### 14: Related Party Transactions

Audit Scotland is a statutory body funded by the Scottish Parliament. The latter is regarded as a related party. Audit Scotland's income arises principally from audit fees and charges levied on public sector bodies. During the period none of Audit Scotland's management staff has undertaken any material transactions with related parties.

### 15: Capital Commitments and Contingent Liabilities

At 31 March 2007 the contracted capital commitments were £613k, payable in 2007/08 in respect of the refurbishment of 18 George Street. There were no contingent liabilities.

# Annual Report and Accounts 2006-07

## Notes to the Accounts (continued)

### 16: Movement in Taxpayers' Equity

	<b>2007</b>	<b>2006</b>
	<i>£000</i>	<i>£000</i>
<b>Opening balance at 1 April</b>	<b>2,705</b>	<b>(10,542)</b>
Local government pension scheme - current service cost	(1,776)	(1,749)
Employer and employee contributions	1,783	2,824
Past service costs	321	(13)
Impact of settlements and curtailments	-	(158)
Net return on assets	631	(193)
Actuarial gains/(losses)	(5,826)	10,372
Movement in general fund ( <i>Note 12</i> )	(546)	2,164
	<u>(5,413)</u>	<u>13,247</u>
<b>Closing balance at 31 March</b>	<u><b>(2,708)</b></u>	<u><b>2,705</b></u>

## **Direction by the Scottish Ministers**

**In accordance with section 19(4) of the  
Public Finance and Accountability (Scotland) Act 2000**

1. The statement of accounts for the financial year ended 31 March 2006 and subsequent years, shall comply with the accounting principles and disclosure requirements of the edition of the Government Financial Reporting Manual (FReM) which is in force for the year for which the statement of accounts are prepared.
2. The accounts shall be prepared so as to give a true and fair view of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year, and of the state of affairs as at the end of the financial year.
3. This direction shall be reproduced as an appendix to the statement of accounts. The direction given on 25 April 2001 is hereby revoked.

Signed by the authority of the Scottish Ministers

*17 January 2006*

# Independent Auditors' Report

## To the Scottish Commission for Public Audit

(Under section 25(3) of The Public Finance Accountability (Scotland) Act 2000)

### AUDIT SCOTLAND

We have audited the organisation's accounts for the year ended 31 March 2007, which comprise the Summary of Resource Outturn, Operating Cost Statement, Statement of Recognised Gains and Losses, Balance Sheet, Cash Flow Statement, Resources by Departmental Aims and Objectives and the related notes 1 to 16. We have also audited the relevant disclosures in the Remuneration Report as required under the direction of the Scottish Ministers. These financial statements have been prepared under the historical cost convention and the accounting policies set out therein.

This report is made solely to the Scottish Commission for Public Audit, as a body, in accordance with Section 22(1) (a) and (b) of the Public Finance and Accountability (Scotland) Act 2000. Our audit work has been undertaken so that we might state to the Scottish Commission for Public Audit those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scottish Commission for Public Audit as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of Audit Scotland and auditors

As described in the Statement of Accountable Officer's Responsibilities, Audit Scotland is responsible for the preparation of the accounts in conformity with the direction of the Scottish Ministers. The Accountable Officer is responsible for the propriety and regularity of the public finances, for keeping proper books and for safeguarding assets, as set out in the Accountable Officer's Memorandum.

Our responsibility is to audit the accounts in accordance with the terms of our appointment, relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you on the matters set out in section 22(1)(a) and (b) of the Public Finance and Accountability (Scotland) Act 2000 and our opinion as to whether the Resource Accounts give a true and fair view and are properly prepared in accordance with section 19(4) of that Act. We also report to you if, in our opinion, the Foreword and the Management Commentary are not consistent with the accounts, if the organisation has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit, or if information specified by the Scottish Ministers regarding the remuneration and other transactions is not disclosed.

We read the other information contained in the Statement on the System of Internal Control, and consider whether it is consistent with the audited accounts. As auditors we are not required to consider whether the Accountable Officer's statement on internal controls covers all risks and controls, nor are we required to form an opinion on the effectiveness of the risk and control procedures. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any other information.

### Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Board in the preparation of the financial statements, and of whether the accounting policies are appropriate to Audit Scotland's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.



# Independent Auditors' Report

## To the Scottish Commission for Public Audit

(Under section 25(3) of The Public Finance Accountability (Scotland) Act 2000)

### Opinion

In our opinion, the accounts give a true and fair view of the state of affairs of Audit Scotland as at 31 March 2007 and of its net resource outturn for the year then ended, have been properly prepared in accordance with section 19(4) of the Public Finance and Accountability (Scotland) Act 2000, and the expenditure has been incurred and receipts have been applied in accordance with section 22(1)(a) and (b) of the Public Finance and Accountability (Scotland) Act 2000: and the information given in the management commentary is consistent with the financial statements.

### H W Chartered Accountants

Registered Auditors  
231/233 St Vincent Street  
Glasgow G2 5QY

22 June 2007

Note 1: The maintenance and integrity of Audit Scotland's website is the responsibility of the Accounting Officer; the work carried out by us does not involve consideration of these matters and accordingly we accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.