

16 March 2023

Alan Williamson
Chief Operating Officer
Edinburgh College

By email to Alan.Williamson@edinburghcollege.ac.uk

Dear Alan

Audit Fees

I refer to your email of 14 February 2023 about the increase in colleges' external audit fees for 2022-23, on behalf of the Further Education Sector's Finance Directors Group. This reply is also intended to cover issues raised during the group's meeting on 10 February, which my colleagues attended. I am sorry it has taken longer than we would have liked to reply to you.

Thank you for raising your concerns with us. We recognise that fee increases are unwelcome at any time, and that this increase comes at a clearly challenging time across the public sector. This letter aims to set out the context and a fuller explanation for the fee increases.

Overall, our budget and resourcing model is designed to ensure we are in position to provide high quality, relevant and independent public audit and assurance to public bodies, decision makers and the public. Maintained rigour and robustness of public audit are vital components of public service.

Audit market

A key factor in setting audit fees is the current audit market and the rising costs that ourselves and the firms we contract face in delivering high quality audit work. There are increased regulatory expectations and risks placed on audit and its quality, as well as a widening in the scope of work audit must cover. This has increased costs throughout both the public and private sector audit markets.

Approximately 35% of financial audits undertaken for the Auditor General and the Accounts Commission are delivered by private sector firms. As you will know, we recently completed a procurement process to appoint auditors for the period 2022/23 to 2026/27. The procurement process was carried out under Open procedure and the Contract Notice published on the Public Contracts Scotland website in September 2021. An anonymised version of the Framework Agreement can be viewed on Audit Scotland's website at the following link - [Audit Scotland Framework Agreement](#).

This exercise confirmed the need to increase fees; the bids from firms were consistent in terms of costs (and thus fees) and were also consistent with our own in-house costing and benchmarking. We have seen this reflected in the wider audit market where private sector fees have increased significantly. By comparison across the UK, audit fees are typically increasing between 50% and 150%. We have done everything we can in Audit Scotland to mitigate the impact of increases on our audited bodies.

The current changes also reflect the absence of discounts from the private sector firms which we had previously benefitted from. For the last six-year appointments the firms offered favourable discounts to deliver audit work on behalf of Audit Scotland; however they can no longer sustain this.

Scope of audit

As above, the regulatory and industry requirements on audit have increased. Aligned to this, public audit has a wider scope than previously. We have consulted with yourselves and the rest of Scotland's public sector on the [Code of Audit Practice](#), the framework that sets out the scope of public audit and the responsibilities on external auditors for the public sector. Following that consultation and agreement on the new Code, those responsibilities and the areas that public audit covers have increased which has a resulting increase in the costs to meet the new requirements.

We have also seen the disruptions of the past few years result in additional work by auditors to ensure they are able to complete the audit of public bodies' accounts and declare them as fair and accurate. This is a crucial factor in providing assurance that public money is spent properly and that such spending is transparent and reported accurately. This extra work, and changes in the way audit is delivered following the pandemic, have again resulted in additional cost.

Audit Scotland

The fee increases come after a period where Audit Scotland has delivered a significant increase in public audit work whilst reducing our budget in real terms over several years. The total Scottish public sector spending that we audit has risen from £27 billion in the mid-2000s to now around £56 billion. The number of public bodies has also increased by a third, and the audit work now includes major new powers such as taxation and social security. At the same time, our budget has dropped by around 20% in real terms since 2005. Our budget represents 0.06% of the spending we audit.

Over recent years we have absorbed the additional costs and resource pressures as much as possible, and at times we have been able to provide public bodies with fee rebates. However, the scope of our work has increased significantly, in the number of accounts we audit, the significant and sharp rises in public spending, and the scope of audit itself. As with all public bodies, we are also dealing with the impacts of high inflation, both on our pay budget and on our operational costs, and we can no longer absorb additional costs on behalf of audited bodies.

Statutory requirements

The legislation which created both Audit Scotland and its functions, the Public Finance and Accountability Act (Scotland) 2000, sets some clear parameters and obligations on us regarding our costs and how we raise and manage revenue to cover those costs.

Firstly, in empowering Audit Scotland to charge fees that cover the exercise of our functions, the Act requires us to break even each financial year and prevents us from holding reserves. We are therefore unable to spread increased fees across years; for example, by carrying a deficit to cover the shortfall in fee income. We have been unable to hold onto any operating surplus in previous years to cover increased costs, and instead in previous years any surplus has been returned to public bodies via fee rebates and to the Scottish Consolidated Fund.

Secondly, the Act states that the costs for audit in each sector of public bodies must be met within "classes" which we interpret as sectors. We cannot spread costs or cross-subsidise

across sectors. This is why different sectors are seeing different levels of rises, specific to the factors affecting each.

Further education

In the further education sector, the average fee increase is 57.5%. This is a significant increase in percentage terms.

The main reasons for the increases are set out above and are most acute in the FE sector due to the size of the organisations and the baseline cost required to deliver a code compliant audit. To deliver an ISA and code of audit practice compliant audit we need to recover the cost of delivering a quality audit. The outcome of the cost of audit exercise, as part of the procurement process, highlighted that to deliver a compliant audit for bodies of a particular size (low and mid) now costs more based on the latest market conditions.

It is important to note that the percentage change is significant, but that the change is less significant in absolute terms. The smallest increase is £8,810 and the largest £25,990. The average fee for an FE organisation under the previous audit appointment was £26,989. Under the new appointment this has risen to £42,506. The minimum FE audit fee is £24,140 and the maximum audit fee is £71,190.

Additional fees

For each audit, Audit Scotland sets an expected fee which assumes that the audited body has well-functioning controls, an effective internal audit service, and an average risk profile. This generates a baseline audit fee estimate. Where an auditor identifies more than average risk or controls that are not operating well, then auditing standards require further external audit work. As you know, unforeseeable extra work can arise from year-to-year on diverse topics including actuarial revaluations of pensions, asset valuations and governance arrangements. This work is not included in the baseline audit fee and may lead to an increase in the audit fee for that year.

The framework contract provides auditors with the ability to negotiate with the audited body and agree an increase in the auditor remuneration part of the fee by up to 10 per cent, or 20 per cent for bodies which have an audit fee below £35,000. Should the auditor believe they need to increase the fee further, they must apply to Audit Scotland for permission to negotiate with the audited body, explaining the circumstances and estimated additional costs.

In closing, I hope this letter provides you with useful context for better understanding the fee increases. As I stated earlier, we recognise that the increases represent additional costs to the college sector. We have been focused on keeping the increases to a minimum and have done what we can to achieve this. However, we also have a duty to ensure we are able to deliver high quality public audit on behalf of the Auditor General and the Accounts Commission. Through this, we are able to provide assurance to public bodies, elected officials, decision-makers and ultimately the public, and to help public bodies improve the services they provide.

I would be grateful if you would circulate this letter to the Further Education Sector's Finance Directors Group for information.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Vicki Bibby', written in a cursive style.

Vicki Bibby, Chief Operating Officer