



Annual Report and Accounts

Year ended 31 March 2006

List of Contents

	Page
Management Commentary	1
Remuneration Report	22
Foreword to the Accounts	25
Statement of Accountable Officer's Responsibilities	27
Statement on the System of Internal Control	28
Summary of Resource Outturn	29
Operating Cost Statement	30
Balance Sheet	31
Cash Flow Statement	32
Resources by Departmental aims and objectives	33
Notes to the Accounts	34
Accounts Direction	46
Report of the Auditors	47

Management Commentary

An introduction to Audit Scotland

What we do

Audit Scotland exists to:

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

Audit Scotland provides objective assessments of governance, financial stewardship and performance on behalf of the Auditor General and Accounts Commission. Audit Scotland operates under the Public Finance and Accountability (Scotland) Act 2000.

As the public audit agency for Scotland, Audit Scotland is at the heart of the governance and performance of public services. Our aim is twofold; to hold public bodies to account and to help them improve. We do this by delivering an independent public audit regime, covering about 200 public bodies in Scotland which spend a total of more than £27 billion a year. We audit around 110 of these organisations in-house and almost 90 audits are delivered by private firms on behalf of the Auditor General and the Accounts Commission.

In our 2005-08 Corporate Plan, we published our three corporate priorities:

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

This management commentary therefore reports our progress against these priorities.

Highlights for 2005/06 have been:

- Eight local government Best Value audit reports published
- Thirty-eight performance audit reports and 196 annual audit reports produced
- The National Fraud Initiative carried out across all local authorities, finding £15m in overpayments and savings
- Modernised audit successfully rolled out in the NHS and piloted in local and central government
- Integrated overview reports published for the NHS and local government
- Assisted the Auditor General and Accounts Commission in the procurement process for the next five-year audit appointments

Management Commentary

Our year

During the year we doubled our output of Best Value audits, saw the first full year of the modernised audit and worked to our three corporate priorities.

We produced 38 reports on the performance of services and organisations, delivered 196 annual audit reports to audited bodies and also delivered a comprehensive study programme.

Together with the Auditor General and the Accounts Commission, we help to ensure that the Scottish Executive and other public sector bodies in Scotland spend public money properly, efficiently and effectively.

The Auditor General is appointed by the Crown and is independent. He reports to the Scottish Parliament and oversees the audits of departments of the Scottish Executive, NHS boards and special health boards, further education colleges, Scottish Water and government agencies.

The Accounts Commission is appointed by Scottish ministers, is independent of local councils and government and can make reports and recommendations to Scottish ministers. Scotland's 32 councils and 35 joint boards are audited by auditors appointed by the Accounts Commission.

This management commentary for 2005/06 sets out our progress under each of our three corporate priorities. We recognise that there is always room for improvement in the way public audit is delivered, and we believe we have made significant progress in delivering an audit regime that is valued by audited bodies, stakeholders and service users.

Our twin aims of holding to account and helping to improve continue to drive everything we do. The past year has seen us make real progress in achieving these goals. For example, 2005/06 saw the roll out of our modernised approach to audit, with the completion of the first full year in health and pilots in both local and central government. We will continue to look for improvements to this new approach but we have been struck by the positive response from audited bodies (whom we see as important clients for this work) and stakeholders.

We are particularly encouraged that in this report we provide some examples of the good work we have found in public services in Scotland. Our role gives us the opportunity to work with many talented and committed public servants and we are grateful to them for their assistance and support during the year. At times it is our role to be challenging as well as supportive, and generally public bodies respond constructively to this.

We continue to strive to keep the cost of audit down, and our annual expenditure remains less than 0.1% of total public sector expenditure in Scotland. We must keep challenging ourselves to deliver public audit more efficiently and effectively, responding to the challenge of best value and minimising the burden of scrutiny.

Looking ahead, we have published our corporate plan for 2006-09 which confirms our three corporate priorities (the plan is available at www.audit-scotland.gov.uk/audit/corpdocs.htm). Our focus is on rolling out the modernised audit and delivering high quality performance audits for the Auditor General and Accounts Commission. We will also aim to provide more support to public bodies in the form of events such as seminars and specialised one-off publications, and focus our work more on the needs of the people who use public services.

Management Commentary

Supporting effective democratic scrutiny

Our work

Our work helps identify where resources can be better used and whether quality is improving.

In 2005/06, among other things, we reported that:

- Transferring the ownership of council houses to social landlords will facilitate £3.2 billion of investment into homes, while keeping rent increases to 1% or less
- Nearly half of patients on waiting lists would travel more than 50 miles to get earlier treatment but only 5% are offered this
- Scottish Water has cut its operating costs by a third, or almost £100 million, in the past three years
- The number of further education colleges operating in deficit halved, from 18 to nine, between 2002 and 2004.

We have a role in ensuring good governance in Scotland's public sector by helping elected and appointed representatives scrutinise public services. We report in public and give those representatives independent evidence to allow them to hold public bodies to account and to help them improve. During 2005/06 we produced 234 reports (246 in 2004/05).

We consult widely on our work programme so we can concentrate on the issues that matter. We aim to understand and report on the experiences of service users and to ensure our reports are clear and timely. As well as highlighting strengths and areas for improvement in the public sector, we focus on the key priorities and risks at the bodies we audit. We enable the Auditor General and the Accounts Commission to bring matters of governance, accountability and improvement to the attention of the Scottish Parliament and ministers.

Reports

The following reports were published during the year:

Moving on?: An overview of delayed discharges in Scotland and Council housing transfers
(these two reports covered matters involving both local government and/or central government/NHS)

6 central government reports

5 NHS reports

8 Best Value reports

(introduced in 2004/05, Best Value audits are designed to give a rounded picture of a council's performance. All 32 councils will be covered in a rolling three-year programme).

5 other local authority reports

(including one Performance Indicators compendium and one PI profiles report)

12 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)

196 annual audit reports to audited bodies

(these are annual summary reports on each public body. They provide an opinion on financial management and highlight the main issues arising from the audit in each body)

Management Commentary

Reports (continued)

5 other publications

(including Corporate Plan 2005-08, two progress reports on race relations and race equality legislation, a guide to Audit Scotland and a Memorandum of Understanding with NHS Quality Improvement Scotland)

Details of most of the above reports can be found in the Reports Published section on the following pages.

All our reports are issued to the relevant audited bodies and most are sent to other stakeholders and published on our website. This allows organisations to share examples of good practice and act on any recommendations. Auditor General reports are considered by the Audit Committee of the Scottish Parliament, and local government and Best Value reports are considered by the Accounts Commission.

The good work we find

During the course of our fieldwork, Audit Scotland finds many examples of good practice and achievement at the bodies we examine. One of the reasons for reporting in public is to share such practice with the rest of the public sector. Among the many examples we reported in 2005/06 were the following:

- By using physiotherapists and GPs with specialist knowledge NHS Grampian is working towards cutting the number of orthopaedic hospital referrals by 40%, or 4,000 cases a year. This aims to free consultants to spend more time performing operations, in turn further reducing waiting times (*Tackling waiting times in the NHS in Scotland*, 16 February 2006)
- At Dalry Primary School in North Ayrshire the strong leadership of its head teacher has directly affected the achievements and experiences of the children and staff. HMIE has praised her impact on the previously struggling school's progress, performance and morale (*Leadership Development: How government works series*, 17 November 2005)
- West Lothian Council and the former West Lothian Healthcare NHS Trust set up a joint health and community care team, with a rapid response service to reduce the need for hospital admissions or enable earlier discharges than previously possible. The team reduced the number of people waiting for discharges by 60% and saved 3,200 bed nights during 2003 to 2005 (*West Lothian Council: The audit of best value and community planning*, 30 June 2005)
- The Scottish Executive and Communities Scotland produced new guidance on the housing transfers due to complete in 2006 and 2007. The guidance benefits from the experience gained in earlier transfers. Improvements to the process mean that current transfers are expected to take just over two years on average to complete (*Council housing transfers*, 24 March 2006)

National Fraud Initiative

Audit Scotland, working with the Audit Commission in England and Wales, external auditors and a range of public bodies in Scotland, facilitated a major anti-fraud initiative as part of the audits of the 2004/05 financial year. The exercise, the National Fraud Initiative, covered all councils, police and fire boards, the Scottish Public Pensions Agency and the Student Awards Agency for Scotland. The exercise used computerised data-matching to compare information about housing benefit applicants, public sector employees and pensioners, students and the deceased, to identify a range of circumstances that might indicate fraud or error. These matches were passed to the audited bodies to investigate and to report back their findings. Fraud, overpayments and savings of £15.1 million have been found. Taking previous pilot exercises into account, the cumulative fraud and error detected by the NFI in Scotland amounts to around £23 million. Audit Scotland will carry out the NFI again in 2006/07, and is working with the Audit Commission to extend the scope of the exercise to other areas that have already produced good results in England and Wales.

Management Commentary

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 the workings of 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.

Links with other scrutiny bodies

Audit Scotland and other bodies put a significant amount of effort into working together to streamline our scrutiny of public services. This is achieved primarily through the Joint Scrutiny Forum and the Inspectorates Forum, and through bilateral agreements. In 2005/06 we signed a Memorandum of Understanding with NHS Quality Improvement Scotland, similar to an existing memorandum we have with the Scottish Public Services Ombudsman. These set out each body's powers and responsibilities, and arrangements for joining up audit and review in public bodies. We also have a track record of joint work with inspectorates and other bodies, such as our joint inspections of education authorities with HM Inspectorate of Education, and joint studies with HMIE, HM Inspectorate of Constabulary, and NHS QIS.

Links with other audit agencies

Audit Scotland is in regular contact with the other public audit agencies in the UK, both through formal and informal means. Audit Scotland takes a full part in the Public Audit Forum (PAF), a body formed by the agencies in the four UK nations to provide a focus for developing public audit, making public audit more efficient and effective, advising on common technical problems and spreading good practice. During 2005/06, Audit Scotland continued to develop links with other audit agencies in the UK with, for example, staff secondments on particular projects. We also undertake the audit of the Scottish-based operations of UK-wide organisations, such as the Forestry Commission.

International development work

Audit Scotland has been involved in a number of projects to help countries across Europe modernise their public governance systems. In 2005/06, two staff members have worked with the Sigma project in Lithuania, Bulgaria, Estonia and Malta. Sigma (Support for Improvement in Governance and Management) is a joint initiative of the European Union and the Organisation for Economic Co-operation and Development. The programme gives support to help modernise public governance systems in new EU countries and EU candidate nations and build public institutions and systems in the Balkan states. During the year we have hosted representatives of the audit offices of Estonia, China, Russia, Western Australia and Denmark. The Auditor General also spoke at a conference in Seville and joined the Audit Committee of the Scottish Parliament on a fact-finding visit to Denmark.

Tendering process for audit work

The Auditor General and the Accounts Commission appoint private firms to carry out about 90 of the annual audits provided for public bodies. At the end of September 2005 we started facilitating the process of making appointments for the period 2006/07 to 2010/11. This included reorganising the portfolios of work to cluster council audits and to appoint the same auditor to councils, health boards and other community planning partners in the same geographical area where practicable. The tender process also stressed the importance of auditors working in partnership to produce more efficient and effective overall audit arrangements.

Management Commentary

Efficient Government Initiative

In the past year Audit Scotland has worked in a number of ways to support the Scottish Executive's Efficient Government Initiative, which aims to make public services more efficient and generate annual savings of £745 million by 2007/08. In February 2005, the Executive formally invited Audit Scotland to audit the Scottish public sector's performance in achieving the plan's targets. We set up an Efficient Government Coordinating Group to oversee our work, which has included:

- reviewing the Executive's Efficiency Technical Notes, which form the basis of the plan's targets. We commented on the work needed to support and monitor the plan
- helping the Scottish Executive's Efficient Government Delivery Group (EGDG) develop guidance on recording and reporting efficiency statements and in specifying audit requirements. During 2006 we will review the public sector's progress on the plan and assess the EGDG's management of it, and report in public
- liaising with our UK public audit counterparts on Efficient Government. This includes sharing information and best practice, and co-sponsoring a joint proposal on developing benchmarks for public bodies' administrative facilities
- developing and implementing a diagnostic tool to assess how well public bodies can identify, monitor, deliver and report efficiency savings. The tool is designed to establish a clear and systematic approach to the audit of Efficient Government and ensure Audit Scotland has 'real-time' information on progress on the initiative. It also aims to establish clear baseline information to highlight key risks and to enable high level comparisons between bodies and sectors.

We will report the outcomes from our Efficient Government audit work through reports to audited bodies, Best Value reports on councils, references in our national studies programme reports, and sector overview reports. We are also planning to undertake more detailed work of some of the plan's key themes once the initiative is well underway.

More information and the diagnostic tool can be found at:
www.audit-scotland.gov.uk/audit/efficient.htm

Statutory performance indicators

In 2005/06 the Accounts Commission changed the way it reported the performance of Scotland's councils against its statutory performance indicators (SPIs). This new approach allowed us to make the SPI Data Compendium (the Compendium) and Council Profiles available on our web site in December, two months earlier than in previous years. This change reflected the needs of our stakeholders, who 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.

As part of the changed system of reporting, we did not publish the accompanying annual series of pamphlets about separate services. Instead, we integrated commentary on a number of key findings from the Compendium into the Local Authority Overview Report published in March 2006. Findings from the SPIs are also used in our Best Value audits and national studies.

As a result of these changes, we saved about £20,000 in publication costs for 2005/06. In future the new approach will also save about £12,500 a year in staff and cover artwork costs.

These reports as well as the SPI Data Compendium and Council Profiles can be found at www.audit-scotland.gov.uk/performance/index.htm

Management Commentary

Reports published in 2005/06

Cross cutting

(Reports for both the Auditor General and the Accounts Commission)

Moving on?:

An overview of delayed discharges in Scotland

together with

Moving on?:

A handbook on modelling the whole system for delayed discharges in Tayside

(both 23 June 2005)

The report highlighted the need for action across all parts of the health and community care system to solve the problem of patients who cannot be discharged from hospital even though they are medically fit to leave. It also found that although the number of patients delayed in hospital was steadily falling, a growing older population meant that further action was needed to sustain this progress.

The handbook focuses on an innovative project in which Audit Scotland worked with the NHS board and three councils that make up the Tayside Partnership to share an understanding of how its local care system worked; identify key factors that lead to delays in Tayside; and develop a computerised model to help Tayside test strategies to reduce delayed discharges.

Council housing transfers

(24 March 2006)

The transfer of council housing ownership is bringing benefits for tenants. The report said management of transfers was improving but better, clearer measures were needed to assess impact and value for money. The hand over of more than 100,000 council homes to new landlords since 1998 has brought more investment in properties - doubling it in Glasgow - and promoted tenant control. It is facilitating increased repairs and maintenance and the building of new homes, and is keeping rent increases down. The Scottish Executive should now reinforce its approach with clearer goals and measures for quality of service and tenant involvement. This would help increase the overall impact and the value for money of transfers.

Central government

(Reports for the Auditor General)

Overview of the water industry in Scotland

(13 October 2005)

Scottish Water has made a good start in raising the water industry's performance but can make further improvements. The report found that since Scottish Water's creation in 2002, the body had improved the efficiency and performance of the water industry and cut operating costs significantly. However, the report said Scottish Water could further improve, and that it faced a challenging timetable for its £1.8bn capital investment programme.

Scottish Executive:

Supporting new initiatives

(How Government Works series)

(10 November 2005)

Last year the Scottish Executive launched new initiatives amounting to £1.4 billion. The management of these projects is generally sound, but making changes could help to improve control of the funding and allow better assessment of whether the money is helping to achieve policy aims.

Management Commentary

Reports published in 2005/06 (continued)

Leadership development (How Government Works series)

(17 November 2005)

Scotland's public sector has good examples of investment in leadership but many individual organisations do not have clear policies and most are unable to link the spending to improvements in their performance. Strategic planning and co-ordination is needed to make sure that the £5m they invested each year in leadership development results in better managed organisations and better services.

Scottish Executive: The NorthLink ferry services contract

(22 December 2005)

The Auditor General asked Audit Scotland to investigate the Scottish Executive's handling of a five-year contract, which began in October 2002, to run the lifeline ferry service to the Northern Isles. This followed reports that the total subsidy paid to service operator NorthLink had risen substantially. The main finding was that the Scottish Executive Transport Group (SETG) carried out a proper tendering exercise and NorthLink was awarded the contract because it submitted the lowest bid for subsidy in accordance with the relevant EC regulations. However there were some limitations in the information originally given to bidders, and SETG has worked with NorthLink to improve this for a new tender.

Scottish Further Education Funding Council: A progress report

(26 January 2006)

The Scottish Further and Higher Education Funding Council, or the Funding Council, is making progress on a number of fronts. Concerns over performance management are being tackled and a more detailed picture of the sector's achievements is emerging. However, the report highlighted areas where further improvements were required, including accumulated deficits at seven colleges, the need for clarity over the strategic direction of further education, and improvements in performance information.

Performance management in Scottish Enterprise

(16 March 2006)

Scottish Enterprise needs to improve how it evaluates its activities to provide a clearer assessment of its contribution to growing Scotland's economy. However this can be difficult to measure and Scottish Enterprise's approach appears to be well advanced compared with international counterparts. The report recommended Scottish Enterprise work with the Scottish Executive to clarify on its contribution to the *Smart Successful Scotland* policy. Scottish Enterprise has met all of its progress measures and introduced new processes and guidance that should help to improve its performance.

NHS

(Reports for the Auditor General)

Waste management in Scottish hospitals:

A follow-up report

(12 May 2005)

The report found that whilst progress has been made since the time of Audit Scotland's earlier study in 2001, NHS boards and hospitals were still not managing hospital waste as well as they could. In particular they needed to increase their recycling and ensure they sorted and stored all waste properly.

Management Commentary

Reports published in 2005/06 (continued)

A Scottish prescription:

Managing the use of medicines in hospitals

(28 July 2005)

Recent years have seen an increase in the number and complexity of medicines available to treat patients and in the types of staff who can prescribe them. The average spend on medicines per patient in an acute hospital has risen by 65 per cent since 2001/02. The NHS in Scotland could improve the management of medicines in hospitals to make sure patients are getting the most benefit from the money spent in this area.

Overview of the performance of the NHS in Scotland

(8 December 2005)

Scotland's health service is achieving better clinical outcomes and cutting most waiting times. The service has improved the availability of treatment and is successfully tackling prioritised conditions such as cancer, stroke and heart disease. However, in other areas performance was mixed and the NHS needs to improve its financial and workforce management to face future challenges.

Tackling waiting times in the NHS in Scotland

(16 February 2006)

The NHS in Scotland has made significant progress towards meeting waiting time targets over recent years but future targets are likely to be challenging. Since 2001 the health service has made good progress in reducing the longest waits for inpatient, day case and outpatient care for people with waiting time guarantees. However the NHS needs to work more on developing approaches across the whole health and community care system to tackle waiting times.

Implementing the NHS consultant contract in Scotland

(9 March 2006)

A new contract for consultants has cost the NHS in Scotland an extra £235m in its first three years but clear evidence of its benefits has yet to emerge. The new contract offers an opportunity to improve patient care by planning consultants' work better, but it is not yet being used to its full potential. The Scottish Executive, health boards and consultants need to work together so that the contract achieves benefits for patients. The Executive can also learn lessons from the implementation of this contract for the management of other large scale projects.

Best Value

(Reports for the Accounts Commission)

Best Value audits were developed in 2003/04 to assess how well councils are meeting their statutory duty to provide Best Value and to give the public an overview of how well their council is performing. The Best Value audits are designed to give a rounded picture of each council, looking at past performance and future plans and taking into account the particular constraints and opportunities facing each council. The first four Best Value audits were carried out in the 2004/05 year, and in 2005/06 Audit Scotland continued to roll out the programme, publishing another eight reports.

Inverclyde Council:

The audit of best value and community planning

(2 June 2005)

The report said Inverclyde Council must take urgent, remedial action to address weaknesses in leadership and direction. Extensive and fundamental weaknesses in the leadership and direction provided by elected members and senior management were significant factors in preventing Inverclyde Council from improving. The report said the council should get appropriate external assistance to address its core problems.

Management Commentary

Reports published in 2005/06 (continued)

West Lothian Council:

The audit of best value and community planning

(30 June 2005)

The report praised West Lothian Council for its ability to transform its ambitious vision for the local area into improving services for the people who live there. The report said the council performed well and was fully committed to continuous improvement.

Dundee City Council:

The audit of best value and community planning

(5 October 2005)

Dundee City Council's services generally perform well for its community. The council is committed to regeneration, has ambitious plans for the city and has made significant achievements in community planning and joint working. But there are a number of improvements required, including the way in which service performance is scrutinised and in the openness of decision making.

East Renfrewshire Council:

The audit of best value and community planning

(11 October 2005)

The report found that East Renfrewshire Council was ambitious and successful and service performance was generally strong and improving. While the report identified some areas for further improvement it stated that East Renfrewshire demonstrated many of the attributes of a council achieving Best Value.

Inverclyde Council:

The audit of best value and community planning - progress report

(30 November 2005)

The report considered the steps taken by Inverclyde Council to address the concerns raised in the Commission's initial Best Value audit report in June. The report said that whilst the council had made progress on its recovery, there was still a long way to go.

Glasgow City Council:

The audit of best value and community planning

(19 January 2006)

The Accounts Commission commended Scotland's largest council for its progress on its improvement agenda and, its commitment to change. However the report acknowledged the significant challenges still facing the council and also highlighted the areas it needed to focus on, including its performance in some key service areas.

The Moray Council:

The audit of best value and community planning

(8 February 2006)

The report stated that the council was not yet in a position to deliver Best Value to the people it serves. The council was described as inward looking, and as having considerable variation in service performance. A number of its practices, including the way in which it managed performance and monitored the competitiveness of its services, were weak.

Management Commentary

Reports published in 2005/06 (continued)

Argyll and Bute Council:

The audit of best value and community planning

(14 February 2006)

Argyll & Bute Council faces particular challenges because of its geographical make-up and the fact that its population is spread over a wide area. However, even taking this into account, the council needs to do more to improve services for local people improve. The council remains traditional in its approach to managing its business and needs clearer leadership and drive to follow through on its initiatives and to embed a culture of continuous improvement in the organisation.

Local government

(Reports for the Accounts Commission)

Improving customer service through better customer contact

(19 May 2005)

The report looked at how councils dealt with requests for services and information from their customers, including taxpayers and business contacts. While councils have made improvements, the report said they needed to review organisation and leadership to ensure their customer service was as efficient and effective as possible.

Following the Public Pound:

A follow-up report

(15 December 2005)

Councils need better information about their funding of external organisations and what is obtained for the money provided. Scottish councils provided £220 million to 14,000 organisations to deliver a wide range of council-related services. The report found that no council fully complied with guidance which sets out best practice principles when councils fund external organisations. There was a high level of performance in nine councils, moderate performance in 18 councils and a low level of performance in five.

Overview of the local authority audits 2005

(30 March 2006)

Scotland's councils are facing major challenges and the report called on them to further increase their pace of change and improvement. Local authorities are working in an environment of major change as central government seeks to reform and modernise public services. They need to pay particular attention to developing their longer term financial planning and improving the information they have about how their services are performing. However financial stewardship at councils is generally sound and statutory performance indicators show overall improvement in a range of areas.

Section 22s

Auditor General reports, made under Section 22 of the Public Finance and Accountability (Scotland) Act 2000, raising issues arising from annual audits of public bodies under his responsibility. Twelve Section 22 reports were presented to Parliament. These reports were on:

The 2003/04 audit of **Inverness College**

The 2003/04 audit of **West Lothian College**

The 2003/04 audit of **Lews Castle College**

Management Commentary

Section 22s (continued)

The 2004/05 audit of **the Scottish Prison Service**

The 2004/05 audit of **Argyll and Clyde Health Board**

The 2004/05 audit of **Grampian Health Board**

The 2004/05 audit of **Highland Health Board**

The 2004/05 audit of **Lanarkshire Health Board**

The 2004/05 audit of **Western Isles Health Board**

The 2004/05 audit of **Scottish Executive consolidated resource accounts**

The 2004/05 audit of **the NHS Pension Scheme Scotland accounts**

The 2004/05 audit of **Inverness College**

Maximising the value of the audit

Delivering the audit

This year saw:

- the first full year of the modernised audit in the health sector
- the development of a Best Value approach for health and central government
- integrated overview reports covering the NHS, local government and the water industry in Scotland.

We aim to continually improve the way we work so our audits can achieve the best possible value and impact for the public. During 2005/06 we continued to develop and roll-out our modernised approach to audit, and refine our methods for Best Value audits and national studies.

To do this we try to ensure our staff have the knowledge and skills to support new ways of working, and to build the experiences of service users into the audit process. We measure the public value of our work by seeking feedback, tracking changes that occur as a result of our work, reviewing the quality of the work and assessing public perceptions of Audit Scotland.

Delivering the modernised audit

In 2005/06 Audit Scotland carried out the first full year of the modernised audit in the health service. We also piloted this new approach in local and central government. Feedback from audited bodies and stakeholders has been very positive, recognising that, through the development of priority and risk frameworks, we are taking the time to better understand what they do. For example:

- Following the first full year of the modernised audit, a survey of health clients found that 82% of clients found their management letters and governance reports either 'excellent' or 'good', while 88% found the annual audit report to be 'excellent' or 'good'

Management Commentary

Delivering the modernised audit (continued)

- In local government, pilots of the modernised audit in the two councils that took part were well received. A post implementation review was conducted on the two pilots, and recommendations have been taken forward into the audits of the 2005/06 year
- In central government, the modernised audit was piloted in three areas of the Scottish Executive. Central government poses a different challenge to the health and local government portfolios in that it covers a wide variety of organisations and subject areas. As a result of changes to the way we managed the Scottish Executive audit, we were able to issue our audit reports on their accounts one month earlier than the previous audit year.

Impact of the modernised audit

Following the full roll out of the modernised audit in the NHS sector in 2004/05, Audit Scotland sought feedback from clients. The response was very positive. Below are anonymised comments from NHS boards.

'The inception of the Priorities and Risks Framework has given a more balanced overall framework for reporting. This is more closely linked with key organisational matters.'

'The targeting of risks to be reviewed and the clarity of reporting of findings are positive aspects. The PRF is a particularly beneficial approach.'

'The most positive aspect of Audit Scotland's reports this year was the overall improvement in the quality. This appeared to be partly due to the Audit Scotland's more risk-based approach which was then reflected in the quality and relevance of the reports.'

While we feel it has been a successful year we continue to seek opportunities to improve the way we deliver the audit. For example, we are currently developing our approach to the local and best value audits to identify ways in which they can be delivered more seamlessly, to the benefit of clients, stakeholder and the audit teams.

Reporting arrangements

In 2005/06, 196* final annual audits were completed. Of these, 113 were done by Audit Scotland and 83 by private accountancy firms.

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 2005/06 auditors reported a range of issues to the Auditor General which he drew to the attention of the Scottish Parliament. This resulted in 12 reports on accounts (Section 22 reports). Some related to technical accounting matters, while others were about issues such as the breach of EU procurement regulations at Western Isles Health Board, potential liability at the Scottish Prison Service and deficits at three FE colleges and four health boards.

There were no qualifications to the accounts of local authorities, for only the second time since local government reorganisation in 1996. There were two 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.

Management Commentary

Reporting arrangements (continued)

Breakdown of audited bodies:

Central government	59
NHS	24
Further education	42**
Councils	32
Joint boards	35
Water sector	1
Total	193*

* These numbers are different because in October 2005 the Scottish Further Education Funding Council and the Scottish Higher Education Funding Council merged to form the Scottish Funding Council. Audit Scotland produced final audit reports for the first six months of the 2005/06 year for both bodies during 2005/06

** During 2004/05 Glasgow College of Building and Printing and Glasgow College of Food Technology merged to form Glasgow Metropolitan College. Audit Scotland produced final audit reports for all three bodies during 2005/06

Delivering quality

We remain committed to delivering a public audit service that is valued by clients, stakeholders and the general public. In order to do this, we need to ensure quality in everything we do. In 2005 we revised the Corporate Quality Framework for Audit Scotland. Building on existing approaches to quality management in the organisation, the corporate framework aims to provide greater consistency in quality control, management and review.

We recognise that quality can be measured in a number of ways and drawn from a number of sources. We have already outlined the emerging impact on clients of the modernised audit. In addition, our Audit Strategy Group undertakes quality appraisals of audits, both those delivered by Audit Scotland and those delivered by external firms. All but one of the auditors appraised in 2005/06 obtained a satisfactory assessment (in 2004/05 all auditors appraised obtained satisfactory assessments). Action was taken by the auditor to change the audit team and ensure that the issues identified were addressed.

The involvement of private accountancy firms in public sector audit continues to support the quality of the overall audit output. In 2005/06 we assisted the Auditor General and the Accounts Commission in tendering for our external appointments for the next five year audit cycle (see page five for more information).

Management Commentary

Building an efficient and effective organisation

Running the business

In 2005/06 we continued our efforts to make Audit Scotland a more efficient and effective organisation. We have been making changes in the way we run our business, just as audited bodies are expected to improve the way they run theirs. Our commitment to continuous improvement is illustrated by the developments in the way we manage our people, processes and technologies.

The task of auditing Scotland's public bodies has expanded greatly since 2000. In 2005/06, Audit Scotland spent £25 million on services for the Auditor General and the Accounts Commission: this is less than 0.1% of the £27 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. Details of Audit Scotland's income and expenditure and financial position are given in the accounts, pages 29-32. For 2006/07 the Scottish Parliament has approved net funding of £6.4 million for revenue costs and £0.5 million for capital.

Audit Scotland is committed to achieving best value in how we manage our financial resources, people and technology. To do this we must ensure our staff have the necessary professional and managerial skills and the appropriate technology, and that we manage our resources efficiently.

We are developing and rolling out a management development programme, and have mechanisms in place to monitor its impact and value for money. Similarly, we are implementing a new finance system. Other projects include an electronic document and records management system, 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 and effectiveness

The Audit Scotland Board is prescribed in statute. One of its main functions is to enable most of the work for the Auditor General and the Accounts Commission to be performed by a single audit agency, with consequent gains in efficiency and effectiveness.

We apply best value principles to everything that we do in managing our resources. For example, over 2004/05 and 2005/06 we were able to reduce audit charges to the NHS in Scotland by 10%. At the same time we significantly improved the audit outputs to NHS bodies and to Parliament. This is seen in the improved financial and performance overview reporting to Parliament, which did not exist before 2000.

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. More than one-third of the value of our annual audit activity is put to competitive tender in the private sector, following full EU procurement rules. This ensures there is a mixed market for public audit provision in Scotland and enables us to set fees at the correct level and contain the overall costs.

Accountability

Audit Scotland is held to account through statutory arrangements put in place by the Scotland Act and by the Parliament through the Public Finance and Accountability Act. The Scottish Commission for Public Audit (SCPA) is central to these arrangements. The SCPA scrutinises our budget and Annual Report and appoints an external firm, Haines Watts, to audit our accounts.

Management Commentary

Accountability (continued)

We carry out quality and Best Value reviews internally. Also, an external firm of accountants performs a programme of internal auditing of all our activities. This internal audit programme is set by, and reports to, the Audit Scotland board's Audit Committee. The committee also receives regular reports on Audit Scotland's risk management process.

Developing people

Audit Scotland employs about 300 people in offices in Aberdeen, East Kilbride, Edinburgh and Inverness. In 2005/06 we introduced a new learning and development strategy, which sets out our commitment to the development of our employees. It involves leadership and management development, as well as a wide range of personal and professional development opportunities for staff at all levels.

We revised our personal development system (PDS) to make it more streamlined and more focused on meaningful discussion between individuals and their line managers.

Developing processes

We delivered a service review of our facilities and administrative management functions, which resulted in taking a more corporate approach to the management of our estate. We also developed and implemented an environmental policy, and gave all staff the opportunity to contribute to this. The policy included setting out and committing to a range of sustainability targets to reduce our impact on the environment.

We have also reviewed our approach to records management and will be implementing a new electronic document and records management system in 2007.

Diversity

We introduced the Diversity Excellence Model into Audit Scotland in 2005/06. We have assessed our current practice against its framework and developed a plan for making diversity an intrinsic part of our work.

Correspondence, complaints and Freedom of Information

In 2005/06, Audit Scotland received 210 items of correspondence (193 in 2004/05) raising issues about the organisations that we audit. We investigate where we assess that there may be an audit issue.

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.

During 2005/06 Audit Scotland met its target of acknowledging correspondence within ten working days in 95% of cases; and in 78% of cases we met our target of providing a full response within one month of the date of acknowledgement. This compares with 98% and 80% respectively in 2004/05.

Audit Scotland welcomed the introduction of the Freedom of Information legislation in 2004/05 and we are committed to its successful implementation. We provide a wide range of information in response to requests every day. We proactively publish the results of our work and issue press releases. Also, a wide range of information is available through our publication scheme.

We keep a log of the 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 2005/06 we logged nine such Freedom of Information requests.

Management Commentary

The Audit Scotland Board and Management Team

Who we are

Audit Scotland Board

Audit Scotland provides services to the Auditor General and the Accounts Commission to enable them to carry out their duties. Its 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. Bill Magee is Secretary to both the Accounts Commission and the Audit Scotland Board, and is also responsible for legal and procedural advice. The board has Audit and Remuneration Committees reporting to it.

The board comprises:

Alastair MacNish

Chair, Accounts Commission

Robert W Black

Auditor General and Accountable Officer

Phil Taylor

Independent Non-executive member

Caroline Gardner

Deputy Auditor General and Controller of Audit

John Baillie

Member of Accounts Commission

In addition, Managing Director of Audit Services **Hugh Hall** acts as adviser to the Board

Management Team

The Management Team is responsible for the day-to-day running of the business. The Auditor General is Audit Scotland's Accountable Officer and leads the Management Team, which also includes Caroline Gardner, Hugh Hall, Russell Frith (Director of Audit Strategy), and Diane McGiffen (Director of Corporate Services).

Management Commentary

The Audit Scotland Management Team

Caroline Gardner

Deputy Auditor General and Controller of Audit

Caroline works with the directors of performance audit on performance studies of public sector organisations and audits of Best Value in councils. She oversees the overview reports on health, local government and central government. Caroline also manages investigations into issues of public concern.

Hugh Hall

Managing Director of Audit Services

Hugh leads the audit services group. They carry out or manage the audits of more than 100 public sector bodies in Scotland. Hugh works with the directors of audit to encourage and support performance improvements and higher standards of accountability in the public sector.

Russell Frith

Director of Audit Strategy

Russell is responsible for procurement and resources, auditing and accounting standards, technical support and quality assurance.

Diane McGiffen

Director of Corporate Services

Diane manages the development of Audit Scotland as an organisation. She leads on business planning and performance reporting and heads up the following services: human resources and training, information technology, finance, administration, and communications.

Our sector teams

Local government

As director of performance audit **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. Typical reports include *Overview of the local authority audits* and *Following the Public Pound*.

Audit services director **Gavin Stevenson** manages the in-house audit service we provide to local authorities, police boards and fire boards, examining their individual performance. His work includes financial statements, governance and performance management matters.

Health and Community Care

Director of performance audit **Barbara Hurst** is responsible for investigating issues of public concern, and producing overview reports and performance studies. Typical reports include *Overview of the performance of the NHS in Scotland 2004/05* and *Tackling waiting times in the NHS in Scotland*.

Audit services director **Lynn Bradley** is responsible for the in-house audit services we provide to the health sector, including the audit of financial statements, governance and performance management matters.

Management Commentary

Our sector teams (continued)

Central Government

In 2005/06, **Arwel Roberts** directed the Central government team, leading both the performance audit and audit services work for the sector. The Central government team covers departments of the Scottish Executive, national public sector organisations such as Historic Scotland and Scottish Water, and further education colleges.

The performance audit team is responsible for investigating matters of public concern, overview reports and performance studies. Typical reports include *Overview of the water industry in Scotland* and *Performance management in Scottish Enterprise*.

The audit services team is responsible for auditing financial statements, governance and performance management matters.

We have recently streamlined our arrangements for managing the Central government and Health and community care teams, following the retirement of Arwel Roberts. Barbara Hurst now directs the performance audit teams for both sectors, and Hugh Hall oversees the team providing audit services to the Central government sector.

Management Commentary

Performance Indicators

We have set a number of indicators to help assess our performance. The indicators, which are set out below, are arranged in accordance with the corporate priorities set out in the Corporate Plan.

Supporting effective democratic scrutiny

Performance indicator	Outcome
No. of performance audit reports published	16 performance audit reports were published* (17 in 2004/05*)
	* this number does not include Best Value or Statutory Performance Indicator reports.
Response times for correspondence from members of the public concerning potential audit issues	In 2005/06, 187 items of correspondence were received. 95% were acknowledged on time. In 2004/05, 193 items were received and 98% were acknowledged on time. 86% were responded to in full within one month of being acknowledged (80% in 2004/05).

Maximising the value of the audit

Performance indicator	Outcome
Percentage of audits delivered against statutory or Accounts Commission timescale for each sector	98% of audits were completed on time (98% in 2004/05). By Sector: Health 100% Central government 100% Further Education 100% Local authorities 97% Other LA audits 94%
Percentage of audit plans submitted and fees agreed within specified timescales	97% of audit plans submitted to Audit Scotland within specified timescales (78% for 2004/05). 72% of fees agreed within specified timescales (37% for 2004/05).

Management Commentary

Performance Indicators (continued)

Building an effective and efficient organisation

Performance indicator	Outcome
Percentage of invoices paid within 30 days	96% were paid within the target time (94% in 2004/05).
Sickness absence	Sickness levels were, on average, 4 days per employee. <i>Average days lost per employee/annum in public services 10.3 days. Source: CIPD Absence Management Survey 2005</i>
Staff turnover	Starters: 35 Leavers: 20 (13 people left in 2004/05)

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, Secretary, Directors and Assistant Directors.

The members of the Remuneration Committee during the year were:

- Chairman – P Taylor
- Member – A MacNish
- 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

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 2006 were in the bands shown as follows:

			R Black	C Gardner	H Hall	R Frith	D McGiffen
			<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>
Salary <i>Note (i)</i>	2005-06	£000	130 - 135	115 - 120	115 - 120	85 - 90	85 - 90
	2004-05	£000	125 - 130	105 - 110	90 - 95 <i>Note (iv)</i>	80 - 85	70 - 75
Estimated value of benefits in kind <i>Note (ii)</i>	2005-06	£	-	-	-	-	3,300
	2004-05	£	-	-	-	-	3,100
Real increase in value of accrued pension		£000	0 - 2.5	0 - 2.5	2.5 - 5.0	0 - 2.5	0 - 2.5
Value of total accrued pension as at 31 March 2006		£000	25 - 30	25 - 30	35 - 40	10 - 15	10 - 15
Lump Sum		£000	See Note 3c	80 - 85	110 - 115	35 - 40	40 - 45
Cash equivalent transfer value (CETV) as at 31 March 2005		£000	See Note 3c	299	451	153	144
Cash equivalent transfer value (CETV) as at 31 March 2006		£000	See Note 3c	333	538	217	174
Real increase in CETV <i>Note (iii)</i>		£000	-	28	81	24	25

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) From 10 May 2004

Senior Management (continued)

Remuneration Report

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. The Auditor General retains office until retirement at age 65, or a later date if determined by Parliamentary resolution.

Accounts Commission

Members of the Accounts Commission are not employed by Audit Scotland and details 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:

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

R W Black
Auditor General
Accountable Officer

23 June 2006

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 2006. 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 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: 96% (2005 – 94%) 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 Haines Watts, 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

23 June 2006

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 2006 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 senior members of the organisation, the Auditor General, the Chairman of the Accounts Commission 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

23 June 2006

Schedule 1
Summary of Resource Outturn
Year ended 31 March 2006

	2006 Estimate £000	2006 Actual £000	2005 Actual £000
Net Total Costs	(6,474)	(4,696)	(8,310)
Net Cash Requirement (<i>see below</i>)		7,932	6,750
Reconciliation of resources to Net Cash Requirement			
	Note	2006 £000	2005 £000
Net Operating Cost (<i>Schedule 2</i>)		4,696	8,310
Capital: Purchase of fixed assets	7	142	369
		4,838	8,679
Adjustments			
Non cash items:			
- Depreciation	4	(361)	(298)
- Notional interest on capital	4	16	35
- Pension scheme - net revenue credit/(charge)		728	(607)
- Movement in net pension liabilities		(11,083)	584
Opening net debtors/creditors		11,640	9,669
Closing net debtors/creditors		1,700	(11,640)
Creditor due to Consolidated Fund	9	454	328
		3,094	(1,929)
Net Cash Requirement (<i>Schedule 4</i>)		7,932	6,750

Schedule 2
Operating Cost Statement
 Year ended 31 March 2006

	Note	2006 £000	2005 £000
Administration Costs			
Staff costs	2	(13,586)	(13,058)
Other administration costs	4	(11,129)	(11,854)
Gross administration costs		(24,715)	(24,912)
Operating income	5	20,278	16,670
Other finance income	6	(259)	(68)
NET OPERATING COST		(4,696)	(8,310)

Statement of recognised gains and losses (SRGL)

	Note	2006 £000	2005 £000
Actuarial gain/(loss) recognised			
Actual return less expected return on pension scheme assets		6,095	726
Experience gains/(losses) arising on pension scheme liabilities		1,479	7
Changes in financial assumptions underlying the present value of the pension scheme liabilities		2,798	(710)
Total gains recognised since last annual report	3	10,372	23

Schedule 3
Balance Sheet
As at 31 March 2006

	Note	2006 £000	2005 £000
Fixed Assets			
Tangible assets	7	550	770
Current Assets			
Debtors	8	7,076	1,477
Cash at bank and in hand		454	328
		7,530	1,805
Creditors			
Amounts falling due within one year	9	6,171	2,956
Net Current Assets/(Liabilities)		1,359	(1,151)
Total assets less current liabilities		1,909	(381)
Deferred liabilities	10	(64)	(94)
Provision for early retirement	11	(1,320)	(1,164)
Net funded pension asset/(liability)	3	2,180	(8,903)
NET ASSETS/(LIABILITIES)		2,705	(10,542)
<i>Represented by:</i>			
TAXPAYERS' EQUITY			
Net funded pension asset/(liability)	3	2,180	(8,903)
General Fund	12	525	(1,639)
	16	2,705	(10,542)

R W Black
Auditor General
Accountable Officer

23 June 2006

Schedule 4
Cash Flow Statement
Year ended 31 March 2006

	Note	2006 £000	2005 £000
Net cash outflow from operating activities	<i>(note a)</i>	(7,790)	(6,381)
Capital expenditure and financial investment	<i>(note b)</i>	(142)	(369)
Financing from the Consolidated Fund (supply)	<i>(note c)</i>	8,058	6,164
Increase/(Decrease) in cash in the period		126	(586)

Notes to the Cash Flow Statement

		2006 £000	2005 £000
a) Reconciliation of operating cost to operating cash flows			
Net operating cost (<i>Schedule 2</i>)		(4,696)	(8,310)
<i>Adjustment for non-cash items:</i>			
- Depreciation	7	361	298
- Notional interest on capital		(16)	(35)
- Pension scheme - net revenue (credit)/charge		(728)	607
(Increase)/Decrease in debtors		(5,599)	4,874
Increase/(Decrease) in creditors		3,342	(3,487)
Adjustment for cash balance due to Consolidated Fund	9	(454)	(328)
Net cash outflow from operating activities		(7,790)	(6,381)
b) Capital expenditure and financial investment			
Purchase of fixed assets	7	(142)	(369)
c) Analysis of financing			
Opening Cash balance payable to the Consolidated Fund		328	914
From Consolidated Fund (Supply)		7,730	5,250
Financing from the Consolidated Fund (supply)		8,058	6,164
(Increase)/Decrease in cash		(126)	586
Net cash requirement (<i>Schedule 1</i>)		7,932	6,750

Schedule 5
**Resources by Departmental Aims and Objectives
for the year ended 31 March 2006**

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

Net Operating Cost	Gross Expenditure £000	Income £000	Net Expenditure £000
2006 Actual	<u>24,715</u>	<u>20,019</u>	<u>4,696</u>
2005 Actual	<u>24,912</u>	<u>16,602</u>	<u>8,310</u>

Annual Report and Accounts 2005-06

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.

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 rent review, as appropriate.

e) Operating income

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

f) 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.

g) Operating leases

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

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

1: Statement of Accounting Policies (continued)

h) Pension arrangements

Audit Scotland has complied fully with the requirements of FRS 17 for the year ended 31 March 2006. 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.

2: Staff Costs and Numbers

Staff costs comprise:	2006	2005
	<i>£000</i>	<i>£000</i>
<i>Administrative Staff</i>		
Salaries	10,647	9,555
National Insurance	922	806
Superannuation	1,873	1,482
Provision for early retirement costs	291	132
Adjustment for retirement benefit scheme costs (<i>see below</i>)	(275)	977
	13,458	12,952
<i>Accounts Commission Members</i>		
Salaries	112	92
National Insurance	7	3
Travel and subsistence	9	11
	128	106
	13,586	13,058

Provision for early retirement costs for 2005 have been restated as a result of re-classifying the amounts required to increase the provision, as advised by the actuary, and other early retirement costs previously contained within Other costs shown in note 4.

The average number of directly employed staff during the period was 279 (2005 – 274). The average full time equivalent number for agency staff used during the period was 14 (2005 – 20).

<i>Analysis of local government retirement benefit scheme costs:</i>	2006	2005
	<i>£000</i>	<i>£000</i>
Current service costs	1,749	1,611
Past service costs	13	305
Curtailement and settlements	11	705
	1,773	2,621
Less: Employees' contributions	(491)	(411)
Charge to revenue	1,282	2,210
Actual contributions	(1,557)	(1,233)
Adjustment for retirement benefit scheme costs	(275)	977

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

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.

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 2006 were as follows:

	2006	2005
Price increases	3.1%	2.9%
Salary increases	4.6%	4.4%
Pension increases	3.1%	2.9%
Discount rate	6.0%	5.4%

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

	<i>£000</i>	<i>£000</i>
Assets (see below)	39,140	24,247
Liabilities	(36,960)	(33,150)
Net Funded Assets/(Liabilities)	2,180	(8,903)
Unfunded liabilities – early retirement provision	(1,320)	(1,164)
Net Funded Assets/(Liabilities)	860	(10,067)

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

	Long Term Return at 31 March 2006	Assets at 31-Mar-06	Long Term Return at 31 March 2005	Assets at 31-Mar-05
	<i>% per annum</i>	<i>£000</i>	<i>% per annum</i>	<i>£000</i>
Equities	7.4%	32,070	7.7%	19,323
Property	5.5%	4,180	5.7%	2,319
Bonds	4.6%	2,310	4.8%	1,624
Cash	4.6%	580	4.8%	981
Estimated employer assets	7.0%	39,140	7.2%	24,247
Total value of liabilities		(36,960)		(33,150)
Net Pension Surplus/(Deficit)		2,180		(8,903)

Annual Report and Accounts 2005-06

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 2006 by Hymans Robertson.

The movement in the funded part of the net pension liability for the year to 31 March 2006 is as follows:

	2006	2005
	<i>£000</i>	<i>£000</i>
Opening net pensions liability at 1 April	(8,903)	(8,319)
Current Service cost	(1,749)	(1,611)
Employer and employee contributions	2,824	1,673
Past service costs	(13)	(348)
Impact of settlements and curtailments	(158)	(253)
Net return on assets	(193)	(68)
Actuarial gain	10,372	23
	<hr/>	<hr/>
Closing Net Pension Assets/(Liabilities) at 31 March	2,180	(8,903)

History of Experience Gains and Losses

	2006	2005
	<i>£000</i>	<i>£000</i>
Difference between the expected and actual return on assets	6,095	726
Value of assets	39,140	24,247
Percentage of assets	15.6%	3.0%
Experience gains/(losses) on funded liabilities	1,479	7
Total present value of liabilities	36,960	33,150
Percentage of the total present value of funded liabilities	4.0%	0.0%
Actuarial gains/(losses) recognised in SRGL	10,372	23
Total present value of funded liabilities	36,960	33,150
Percentage of the total present value of funded liabilities	28.1%	0.1%

During the year ended 31 March 2006, Audit Scotland's contribution to the pension fund represented 18.9% (2005 – 18.0%) 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 the next three years, commencing in 2006 – 07.

The significant movement from net liabilities to net assets in the local government scheme is due to a combination of high returns on equities during the year and an increase in the discount rate, a result of implementing the new Financial Reporting Manual requiring Audit Scotland to adopt the specified real discount rate of 2.8%.

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

3: Pension assets and liabilities (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 2005 were estimated at £84.1 billion. Further details may be found in the separate scheme statement of the PCSPS (www.civilservice-pensions.gov.uk).

During the year ended 31 March 2006, Audit Scotland paid an employer's contribution of £304k (2005 - £223k) into the PCSP scheme at rates between 16.2% and 24.6% of pensionable pay (2005 - 12% to 18.5%). Audit Scotland has been informed that contributions will increase from April 2006 to between 17.1% and 25.5%. 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 2006, Audit Scotland paid an Employer's contribution of £30.8k (2005 - £23.0k) 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 2005-06

Notes to the Accounts (continued)

4: Administration Costs

	2006	2005
	<i>£000</i>	<i>£000</i>
<i>Fees and Expenses to appointed audit firms:</i>		
Local authorities	3,075	2,835
National Health Service	1,811	1,849
Water	167	148
Further education	427	388
Scottish Executive and sponsored bodies	472	455
	5,952	5,675
<i>Other Costs:</i>		
Rent and rates	945	789
Other accommodation costs	464	407
Travel and subsistence	851	743
Legal and other professional fees	813	1,055
Stationery and printing	375	359
Training	433	482
Staff recruitment	71	399
Communications (telephone, postage)	103	135
Insurance	172	135
Information technology	424	415
Audit fees: Internal	22	26
Audit fees: External	33	31
Other	126	49
VAT on revenue expenditure (<i>see below</i>)	0	891
<i>Non-cash items:</i> Depreciation	361	298
Notional interest on capital	(16)	(35)
	5,177	6,179
	11,129	11,854

Rent and rates includes £696k in respect of property leases (see note 13).

Value Added Tax

During the year ended 31 March 2004 HM Customs & Excise confirmed its view of Audit Scotland's VAT position that all VAT expense is irrecoverable.

Up to 31 October 2004 input VAT was recorded as a separate expense and met through funding from the Scottish Consolidated Fund. From 1 November input VAT has been included in the individual costs and recovered through charges to audited bodies. Accordingly the detailed analyses of Administration Costs are not directly comparable between years.

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

5: Operating Income

	2006	2005
	<i>£000</i>	<i>£000</i>
<i>Fees and charges payable:</i>		
- by Local Authorities	13,229	9,619
- by National Health Service bodies in Scotland	4,402	4,293
- by Water bodies	169	201
- by Further Education Colleges	553	605
- by Scottish Executive and sponsored bodies	1,590	1,591
	19,943	16,309
Bank Interest	145	134
Rent from External Tenants	0	10
Miscellaneous Income	190	217
	20,278	16,670

6: Other finance income

	2006	2005
	<i>£000</i>	<i>£000</i>
Expected return on local government pension scheme assets	1,803	1,583
Interest on pension scheme liabilities	(2,062)	(1,651)
	(259)	(68)

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

7: Fixed Assets

	Leasehold premises	Furniture and fittings	Computer equipment	Total
<i>Cost</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
At 1 April 2005	367	354	1,367	2,088
Additions	43	0	99	142
Disposals			(407)	(407)
At 31 March 2006	410	354	1,059	1,823
<i>Depreciation</i>				
At 1 April 2005	161	326	831	1,318
Charge for the year	56	11	294	361
Depreciation on Disposals			(406)	(406)
At 31 March 2006	217	337	719	1,273
<i>Net Book Value</i>				
At 31 March 2006	193	17	340	550
At 31 March 2005	206	28	536	770

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.

8: Debtors

	2006	2005
	<i>£000</i>	<i>£000</i>
Trade debtors:		
other central government bodies	526	53
local authorities	4,095	
NHS bodies	1,473	
public corporations	63	
bodies external to government	291	
	6,448	53
Work in progress	100	918
Prepayments	528	505
Ombudsman	0	1
	7,076	1,477

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

9: Creditors

	2006	2005
	<i>£000</i>	<i>£000</i>
<i>Amounts falling due within one year:</i>		
Trade creditors:		
Local Authorities	43	140
NHS bodies	10	
Bodies external to government	<u>267</u>	<u>366</u>
	320	506
Cash balance payable to Consolidated fund	454	328
Deferred income	5,036	1,103
Other taxes and social security costs	0	265
Superannuation	8	175
Accruals	323	549
Rent free period on premises – current liability (<i>Note 10</i>)	30	30
	<u>6,171</u>	<u>2,956</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.

	2006	2005
	<i>£000</i>	<i>£000</i>
Opening balance at 1 April:		
Current	30	30
Deferred	<u>93</u>	<u>123</u>
	123	153
Additions	-	-
Released during year	(29)	(29)
	<u>94</u>	<u>124</u>
Closing balance at 31 March		
<i>Whereof:</i>		
Current	30	30
Deferred	<u>64</u>	<u>94</u>
	<u>94</u>	<u>124</u>

Annual Report and Accounts 2005-06

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:

	2006	2005
	<i>£000</i>	<i>£000</i>
Opening balance at 1 April	1,164	847
Additions	162	253
Utilised in year	(84)	(68)
Revaluation	78	132
Closing balance at 31 March	1,320	1,164

12: General Fund

	2006	2005
	<i>£000</i>	<i>£000</i>
Opening balance at 1 April	(1,639)	263
Opening Cash balance payable to the Consolidated Fund	328	914
Funding received from Consolidated Fund	7,730	5,250
Closing Cash balance payable to the Consolidated Fund	(454)	(328)
Net funding from Scottish Parliament	7,604	5,836
Net Operating Cost	(4,696)	(8,310)
Notional interest on capital	(16)	(35)
Transfer to net funded pension liabilities	(921)	539
Net return on assets	193	68
Closing balance at 31 March	525	(1,639)

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

13: Leases

During the period to 31 March 2006 the amounts charged to revenue in respect of operating leases for premises and equipment were as follows:

	2006	2005
	<i>£000</i>	<i>£000</i>
Premises (<i>Note 4</i>)	696	536
Equipment	431	391
	<u>1,127</u>	<u>927</u>

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

Lease expiry	2006		2005	
	Premises	Equipment	Premises	Equipment
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Within one year	5	45	-	58
In two to five years	-	323	-	186
After five years	692	-	696	-
	<u>697</u>	<u>368</u>	<u>696</u>	<u>244</u>

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 2006 the contracted capital commitments were £24k, payable in 2006/07 upon the completed implementation of the new finance system. There were no contingent liabilities.

Annual Report and Accounts 2005-06

Notes to the Accounts (continued)

16: Movement in Taxpayers' Equity

	2006	2005
	<i>£000</i>	<i>£000</i>
Opening balance at 1 April	(10,542)	(8,056)
Local government pension scheme - current service cost	(1,749)	(1,611)
Employer and employee contributions	2,824	1,673
Past service costs	(13)	(348)
Impact of settlements and curtailments	(158)	(253)
Net return on assets	(193)	(68)
Actuarial gains/(losses)	10,372	23
Movement in general fund (<i>Note 12</i>)	2,164	(1,902)
	13,247	(2,486)
Closing balance at 31 March	2,705	(10,542)

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, recognized 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 2006, 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 2006 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.

HAINES WATTS
Chartered Accountants
and Registered Auditors
231/233 St Vincent Street
Glasgow G2 5QY

23 June 2006