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Draft Local Audit Bill ad hoc
Committee

Draft Local Audit Bill: Pre-legislative Scrutiny

Report of Session 2012–13

Volume I

*Volume I: Report, together with formal
minutes, oral and written evidence*

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Examination of Witnesses

Witnesses: **Robert Black**, former Auditor General Scotland, **David Walker**, former director of public reporting at the Audit Commission, **Professor David Heald**, University of Aberdeen, and **Jessica Crowe**, Centre for Public Scrutiny.

Q102 Chair: Welcome. Thank you to all of you. I particularly thank David Heald, who I know has put himself out to come back to London yet again to give evidence this afternoon. We have about an hour and four people, all of whom have a huge amount to say, so the more succinct we can keep our contributions, the more we can get through. We have identified five or six areas and no doubt you will want, at the end, to mention some that we have not.

I am going to start with a general question.

David Walker: Before you do, the figure that you are after is in the annexe to the Bill.

Q103 Chair: Which figure?

David Walker: The figure for the cost of abolishing CAA, which was given by the Government as £28 million in the baseline year of 2009–10. That is the cost to the commission. The cost of compliance with the inspection regime—and it sounds plausible—is £218 million over 10 years at NPV, gets you near to the figure—

Q104 Chair: Thank you.

David Walker: The figures are there and you can argue about whether compliance costs are as much as that, but there is a real figure in the Bill.

Q105 Chair: I shall ask David Heald to start with this one, but all of you chip in, please. Our job is to look at the draft Bill, so we would find it really helpful if you, again, told us what you think are the key risks and key gaps in that proposed legislation. All of you have a go at this.

Professor David Heald: I think it is a bad Bill and I think that reflects the evidence I gave to the Select Committee on Communities and Local Government last year. Nothing has happened to make me change my mind about that. I believe fundamentally in the Sharman principle that public sector bodies should not appoint their own auditors. It was quite striking when the Government Resources and Accounts Bill was going through Parliament that the then chairman of the Public Accounts Commission, Robert Sheldon, and the then Chairman of the Public Accounts Committee, David Davis, persistently raised this issue, often at quite irrelevant times, and kept going on the issue about public bodies not appointing their own auditors. Essentially, it was about executive non-departmental public bodies, but after the Sharman report, the NAO got the appointments of these bodies. I find it astonishing that, not much more than 10 years later, we have gone off completely in the opposite direction. The critical point was when, as a political decision, the Audit Commission lost the foundation trust audits. That was the critical point, and nobody made a big fuss about it at that time. Subsequently, one sees that everybody says that they want to appoint their own auditors.

The detailed discussion that you were having with the previous witnesses shows the actual, practical difficulties of establishing a satisfactory regime. I

believe that there are strong reasons for having a central appointment organisation to do the appointments of auditors. If that is politically off the agenda, as the very least bad solution I would go along with Mr Betts' argument of a double lock.

Q106 Mr Bacon: Can you just remind us: the double lock being the audit committee and the full council?

Professor David Heald: The auditor panel strikes me as a crazy idea. I cannot see where the independent expertise for so many authorities is going to come from.

Q107 Mr Bacon: I am asking a question about the double lock, not about the panel.

Professor David Heald: Yes; so given the fact that I think the auditor panel has got to go, I think the right place to put it is in the audit committee, making a proposal that is accepted by the full council. I do not regard it as satisfactory, because of my principled objection to public bodies appointing their own auditors. If the Bill is going to go through in broadly its present form, I think the double lock is actually the best. The audit committee proposes and the council accepts, and I think the same kind of arrangement would have to happen about removal of auditors.

Q108 Chair: Can I just ask you, because Michael O'Higgins said in an article in *The Guardian*, or something, on trusts that now appoint their own auditors, there has been no public interest report: I do not know whether any of you have done any work that demonstrates—because in a sense that is our example of where you have a public body appointing its own auditors—where is the detriment. Is there evidence of detriment in that mechanism that has now been around for three, four or five years? I cannot remember when it was first implemented.

Professor David Heald: I do not know of any academic work on that. It takes quite a lot of time, because the statistical techniques need a number of years to establish that. I do not know of anything that has actually been done yet.

David Walker: Hearsay says Monitor is sitting on 25, 30 or 40 foundation trusts that are in imminent financial difficulties. If, in the period preceding the announcement of their difficulties—we have seen announcements in south-east London—the auditors have been silent, that must say something critical about the audit regime, surely.

Q109 Meg Hillier: I wanted to ask Robert Black what the situation is in Scotland, in terms of maintaining independence, because I think that might be a useful comparator.

Robert Black: I am very happy to do that. If I may, I will just give you a quick thumbnail, and then perhaps comment on this very important issue about the appointment of auditors.

In Scotland there is a single audit agency, Audit Scotland, of which I was the head until this summer.

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May I just put in the record that I am speaking in a personal capacity now, but I am sure nothing I say will be at variance with what my erstwhile colleagues consider appropriate? There is a single public audit agency, called Audit Scotland, which in a sense captures a large number of the properties of the National Audit Office, and some of the properties of the Audit Commission. That gives the advantage of the single point of contact. We can do very good analysis of delivery chains, cross-cutting studies, and so on. We do not have any institutional or organisational barriers to that.

The audit process is managed through Audit Scotland on my behalf, so rather like the Audit Commission used to operate, there is a tendering of the audits every five years. If you take public bodies in Scotland—something over 200 of them—they each have an appointed auditor, who is either someone supported by a team from Audit Scotland, rather like the old district audit service, or is someone from a firm. We employ the same large firms as feature in England.

On the specific point about the advantages of independent audit, what I would say in Scotland is that I would be confident that the Scottish Parliament would be very concerned if there were a suggestion that each and every local authority or health body appointed their own auditors, because what they see in Scotland is that the audit reports are coming to them through the Auditor General or through the Accounts Commission. So when I was reporting to the Scottish Parliament—I must use the past tense for this—I could dwell on the content of all the audit reports for the umpteen health authorities, and so on. There is a body called the Accounts Commission, which oversees the local government; we work in the same partnership. So the strategic insight provided on the performance of the health service and the finances of the health service is found in the local audit reports. The final point I would make on that is there is a sense in which he who pays the piper calls the tune. So the audits are conducted according to a code of audit practice, and all the established standards at UK and international level. There is no question about that, but you can influence the shape of the audit according to the issues of concern either to me or to the Scottish Parliament. So you get that degree of control as well as giving a public reassurance about the fact that the auditors are not in any sense beholden to the bodies that appointed them.

Finally, when it comes to the public interest reports, what invariably happened in Scotland is that issues would arise in a local authority, there would be a fairly good professional conversation between senior colleagues in Audit Scotland and the appointed auditor. Then Audit Scotland would come in behind the auditor and support them, and ultimately make the reports to Parliament or to the Accounts Commission. In a sense, it limits the risk and exposure of the firms, because the tough stuff is taken by Audit Scotland to take it into the democratic arena.

Q110 Chair: Going back to my original question, that has been a helpful exchange of risks and gaps, but is there anything else you think we need to build on?

Jessica Crowe: We start from perhaps a slightly different point from some of those already made. To add something new is that we would say that it is important for audit to be seen as part of a wider culture of accountability in local public bodies. For us, one of the big gaps and problems with the Bill is the increasing fragmentation and gaps in accountability.

It is a missed opportunity, as lots of public bodies are increasingly working together and there is a prospect some day of community budgets becoming quite significant, more pooled budgets and more joint budgets. The fact that health is missing has been referred to, but more widely it is a missed opportunity to do something about looking more sensibly at how public bodies spend their money in the round, and how they account to local populations.

For us, there is a bit that is not in the Bill and is not talked about unless something follows on. We would say that the important thing is the simplicity and the way in which accounts and audits are presented to the public. If the Government are serious about transparency being an aim, all this process about who is the auditor and who appoints them, is not going to make it any simpler for any resident to understand how their council or anybody else spends their money, because public accounts are completely opaque and incomprehensible.

Q111 Chair: So, that is your ambition. In terms of the draft legislation, what is not in there that you would want in order to realise that ambition?

Jessica Crowe: Something about the NHS and how health bodies are going to be tackled.

Q112 Chair: We are having a separate session on the NHS.

Jessica Crowe: It may be something that comes more into regulations because there are lots of powers in the Bill for the Secretary of State to make regulations. If we are going to go down the path of bodies appointing their own auditors, we think there are more safeguards that could be put in, either in the Bill or through regulations, about how panels and independent members of committees are appointed. Things such as confirmatory hearings would make it much more local and public, and the role of the monitoring officer could act as an additional safeguard separate from the section 151 officer. There are things one could do within what is being proposed to strengthen it a bit.

Q113 Meg Hillier: Can I just ask about your role? You are in a way representing local authority and other members through the Centre for Public Scrutiny, in a sense, although we have other representatives. We talk about independence, and there has been discussion about council members having a role. Do you think there is sufficient independence? Sometimes scrutiny differs from authority to authority in how independent it is. Do you think there are some issues there? Perhaps you could develop that. The other question to think about is: you were a commissioner in Doncaster.

Jessica Crowe: I still am.

Q114 Meg Hillier: You still are? Perhaps it is a lifelong appointment. We have also had problems in Westminster in the past. Perhaps you could give some flavour from your experience about what happens when things get really difficult, and the impact on the independence of auditors there.

Jessica Crowe: Yes, there are all sorts of issues there. We would very much endorse the findings of Clive Betts's Committee about the potential for scrutiny to be enhanced and strengthened, to play more of a role in backing up the more technical role of looking at financial statements. What you cannot do in a single audit of a single year's accounts is assess the long-term or social value that is being achieved through spending public money—the social impact. That is something that we feel that scrutiny functions could play a role in.

We would say that such powers could be strengthened; there is a power to require people to attend auditor panels to give evidence, and we have long argued that scrutiny committees should have that power—as Select Committees do—to call for persons and papers and to require people to attend if they have concerns. We think that there are things that could be done to strengthen that side of how local authorities are held to account.

It is a truism wherever I go, people say “Scrutiny is a bit patchy, isn't it?” That is the word used to describe scrutiny. I think that that is true, but if local authorities are going to be set free in this localist world, then it has to fall to local elected members who have the democratic accountability to do more holding to account of the officials who spend the money. There do need to be more resources and the powers I talked about; those things are both difficult, particularly the resources in the current climate. That is a challenge, that we are loading more responsibilities on to the local level at a time when local authorities are struggling financially.

Q115 Chair: I was going to go to David Walker, just on gaps and the main risks.

David Walker: You do not want to hear me repeating what Jessica said. It is a missed opportunity. Here are inconsistent audit regimes across local government, schooling, further education now, and health—this could have been a great chance at least to try to introduce principles of consistency, such that if you are spending public money in the local space you observe the same audit code and the same regime for ensuring that that money is well spent. You have taken that on board, so I suppose the main point that I would make is that this is an own goal. Here we are—cliché—in the midst of the age of austerity, and here was an opportunity to bed down a regime for maximising value for money from local public expenditure. That has been missed.

If you asked yourselves the question, as I am sure you will be asking other witnesses, “Who is now responsible for value for money in the local space?”, you will get a cast, literally, of thousands, from the NAO through to the members of audit panels and auditors themselves. There is no obvious mechanism now for linking up the work that auditors do with the thrust to secure, for example, benchmarking material

that would allow you to say whether a given public body or local authority is spending that money as effectively as possible. You could argue that at this moment we can least afford that potential for waste.

To add to that briefly, let us not forget that the Audit Commission—according to the 1981 Act—was not really about VFM; it acquired value-for-money duties as the years went by, under the Conservative Government and under the Labour Government. It established a regime, now thought to be excessive, for looking at public services in the round, in the shape of the comprehensive area assessment. That was intended to be a mechanism for demonstrating to local people and local elected members that the spending they were doing matched up with the spending in comparable areas. Comparability remains the huge, huge issue in trying to see whether spending is being done appropriately. I cannot see, looking at the draft Bill, where you would extract proper measures of comparability and proper benchmarking that alone would give you, locally or centrally, a purchase on whether the spending is effective.

Q116 Chair: So would you all agree with what our previous witnesses said on that issue, that there ought to be a duty—probably on the NAO—or a power for the NAO to instruct auditors to collect particular information to enable that comparability and benchmarking to take place? Do you think that that would be the way to deal with it? Any views on that?

David Walker: Short of creating a new body, and we are not in the business of creating new quangos, let us at least go with an organisation that has demonstrated capacity—

Q117 Chair: But you would have to give them a power that is not in the Bill.

David Walker: I would give them a duty.

Chair: A duty.

Professor David Heald: What concerns me is that the NAO has been given a hospital pass. The NAO cannot win out of these changes. It either makes a success of them and people will say, “Well, just privatise the audit function within the NAO”, or it fails and it will actually be held responsible for serious problems at the local level. The notion that six value-for-money studies done by the NAO, within the Bill's rather limited powers of access, could possibly replace what was done by the Audit Commission is fallacious. The NAO is in a very difficult position. Also, accounting officers are going to be in a very difficult position, because they will not be able to give Parliament the same kind of assurances about value for money and probity having been achieved.

I was personally against outsourcing the audit practice of the Audit Commission. The one point I would make is that when it comes to financial certification audit, the private audit firms are perfectly capable of doing that work, although in the past they were greatly helped by the framework set by the Audit Commission. They have got much less of a track record in the value-for-money area, and it seems to me that one thing that is happening in public audit is the rolling back of value for money. There is an interesting point about individual attention—about the

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NAO not looking at individual local authorities. How can you give an assurance to accounting officers and to Parliament without any power in respect of individual local authorities?

On the financial audit side, I do not think that there is a particularly serious problem, and I do not doubt that the outsourcing programme brought genuine savings in the medium term, but there are fundamental questions about accountability to Parliament from the point of view of accounting officers. When I was preparing for today, I re-read “The Proper Conduct of Public Business”, which was one of the publications of your predecessor Committee, and reflected on how long it would be before we got a similar kind of report. I think there are very serious dangers.

Q118 Mr Betts: Is this a concern about the general spending of public money and lack of accountability, or is it a concern that individual authorities could start to get into the difficulties we talked about with the previous witnesses? Although the Secretary of State has the power to intervene, ultimately, in such a conflict, the information may not be coming through to allow that intervention to be timely.

Professor David Heald: Yes. There is a difference between the councils or public bodies that reach the point of intervention. The Audit Commission had early warning knowledge of where there were difficulties. If I were a Minister, what would worry me is being caught by surprise, whereas with the Audit Commission regime you were much less likely to be caught by surprise. The Audit Commission had a direct relationship with auditors, which, under the Bill, the National Audit Office will not have. It is a question of having inside intelligence of which councils are likely to be in trouble.

I did research on the use of resources assessment, and contrary to the view that is promulgated in the impact assessment that there was zero gross benefit from the CAA and such systems, I found that local authorities were actually quite positive about the use of resources assessment. It helped them to benchmark themselves against other people.

Q119 Mr Betts: Without going back to the CAA, which I think is quite likely not to happen, you still have a duty on the NAO to take the oversight of what is happening in local audits and have that information fed back to them so they could anticipate problems and advise the Secretary of State accordingly. Outside any reconstruction of the CAA you could still have that duty to assist in that way, could you?

Professor David Heald: I have publicly objected to dumping functions of the National Audit Office. I think that is a dangerous tendency. Given where we are, the NAO having the audit procurement role, and hence access, would strike me as the best option.

Q120 Mr Betts: They have to have the procurement role as well.

Professor David Heald: The NAO would procure and regulate audit as well as having codes of practice.

Jessica Crowe: It is important not to confuse the audit role and the Commission’s other work in improvement and performance in the inspection. The question about

Doncaster is relevant here, although that is separate, and the LGA and the local government sector are setting up a whole separate way of gathering that kind of early intelligence about local authorities that are in difficulty. In my experience, both when I was a councillor and in my current role as a commissioner, it is not primarily or solely about the financial controls in an authority. Weaknesses there are a symptom rather than a cause of an authority getting into difficulties. It is much more about the culture and behaviours of the organisation in terms of how to do your business properly and about governance more widely. Those things can be tackled in other ways and audit is an important contributor to that, but it does not have to be relied on to do everything.

David Walker: Can I just interrupt? The Local Government Association has for two years now been putting together a website called “Inform”, which was meant to be a pool into which the public—people—could dip to find information about local expenditure. I tried to access it yesterday and the message came back, “You can only access it if you’re a local authority elected member, or”—There is a problem with local government’s own capacity to look at itself in a potentially critical way. I think that is something you will need to deliberate upon as you think about this Bill.

Robert Black: Could I just reiterate that I have no deep knowledge or expertise in the situation in England? So anything I say is designed to be as helpful as I can be to the Committee, from the experience of an increasingly different audit regime which is operating north of the border.

I recognise what David Heald is saying: the audit of financial statements will kind of take care of itself, because it is core business and is well regulated. On the specific point of no surprises, just to share with you how it would work in Scotland, two points. I would regularly, personally, meet the auditors to understand the issues which are emerging and developing at the local level. From many years ago—although I was an honorary auditor for 12 years, as the Auditor General—I have a planning qualification and I am used to being asked, “What are you achieving? Stopping bad things happening?” There is an element of that around audit. The public value is to prevent mistakes and one can only do that by early conversations and detection. That is the first point. There is something about that “no surprises” which is really important, which we do have in Scotland.

The second thing is that we are faced, as you can imagine, with the same pressures for efficiency. The way in which that is happening in local government is that we developed a regime which provided for a joint risk assessment of each local authority—each of the Scots local authorities—prepared by Audit Scotland, if they were appointed auditor, and the firm and also the inspectorates, and they would work with the management of a local authority to do that. So it would be an agreed document. That shared risk assessment now informs and shapes the audit work and it has also helped us make the scrutiny work more proportionate, because you can concentrate on issues that matter. It does not mean that something will not

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jump out of the woodwork, but nevertheless it is a system that kind of tries to manage that.

Q121 Ian Swales: I think you have raised an interesting point about other bodies. We have talked about the NHS. You mentioned education. Of course, virtually every department has some kind of dispersed activity, so it raises the question, we have this clunking tome for DCLG, how does it compare to what everybody else is doing? I think that is one for the Committee. Of course, the Public Accounts Committee has big concerns about the amount of public money that is disappearing out through arm's length bodies, although I guess that is outside the scope of today's sitting.

On performance and value-for-money work and thinking about it from the professional firms' point of view, we know that lots of corporations—I was part of this at one time—got their audit bills down simply by giving the auditors sufficient assurance that they could sign off the legislative true and fair view, and all that kind of thing. That is one extreme. I wonder, when a professional firm is taking one of these contracts, how do we ensure that we get the quantity of activity that we think we are actually buying? In other words, could they make a lot more money by simply doing a heck of a lot less work than we expected? We do not have the framework in which they are going to operate. How can you give us an assurance that we can make sure that the professional firms, who, let's face it, are in it to make a profit, will actually deliver the quantity of activity, particularly in the optional areas, around management information, performance assessment, value for money, and so on, and does the Bill adequately put the framework in place?

Professor David Heald: My experience is that private audit firms do what they are paid to do. If you get the audit bill down, you will get less work. It may be a cost saving in the short run but subsequent difficulties may emerge. It may also make the audit firm less willing to have big fights. One of my research interests is about private finance initiative accounting. I have kept making the distinction about the attitude of the National Audit Office to PFI accounting. Under UK GAAP, where accounts were audited by the NAO, generally things were on balance sheet. If they were audited by the Audit Commission or its appointed auditors it was generally off balance sheet. In the whole of my career I have never known a subject where people were willing to tell me things in private which so departed from what they said in public. The game was about the public sector comparator versus the PFI and everybody knew what the answer had to be at the end of the day.

It was an insider secret that these assessments were manipulated. That has been put right by the move to IFRS and to a control criterion rather than the abused risks and rewards criterion, but I worry during the period of fiscal austerity that we are going to find all sorts of other things coming up. The Public Accounts Committee is going to have to start worrying about things like fragmented bodies and about guarantees. The number of times I have read that guarantees are costless to the public purse—I just find it amazing that

anybody can suggest that. There will be a whole set of other issues.

Coming back to your question, if you force audit fees down too far, people will not have the stomach for a fight. The justification I got in private from the big firms was that the rest of them did it like that as well. So people took safety. This is not based on direct evidence, but my impression was that the auditors in the Audit Commission dare not go against what the private firms were doing.

Q122 Ian Swales: That is an interesting dark view of the world. We raised with the earlier witnesses the question of whistleblowing. One of the possibilities was that access to a body's auditors was one way that whistleblowers might operate. Being realistic and looking at it from a professional firm's point of view, do you see that as a function that they could perform? Would it work and does it need covering in the Bill somehow in terms of their duties?

Professor David Heald: I would not have any experience on that topic but if they have signed up to a particular audit regime they are going to want incremental payment for additional activities.

David Walker: There is a very brief historical part answer to your question. I appeal, as it were, to the municipal experience of the Chair and Clive Betts. Once upon a time the district auditor was a figure who carried civic authority and was regarded by, for example, local authority leaders as someone who would be proactive in the public interest. It is not inconceivable that a private auditor would carry public interest, but it is much less likely. Unfortunately, one of the aspects of what is happening is the loss of an historic identity of the district audit. District audit was for a hundred years or more a very important part of the local service delivery landscape because auditors were always there potentially.

Q123 Ian Swales: Just one point on that. You have raised another interesting point which is that if we nail the fees down through this process then we are not paying for proactivity and that kind of independence and extra work, are we? So that function you described in a district auditor we have designed out as a result of this regime. Is that correct?

David Walker: To be fair, there is a large debate going on in various parts of the private accountancy world about the role of auditors in their audit of private companies, which debate might lead to a redefinition of the "public" responsibility of private sector auditors in the private sector, which might in turn feed through and make private auditors appointed to public audit more aware of the wider context. As things stand, there is an issue.

Q124 Mark Pawsey: Can I ask about the deterrent effect of the auditor? One of the reasons the audit is there is that the police and people know that if wrongdoing takes place the auditor will find it. If it becomes known that there is a less stringent regime, with less value-for-money work being done, is there a danger that those who might be contemplating doing something inappropriate are more likely to proceed, in your view?

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David Walker: That has to be the case, otherwise why would we employ police officers, even if reduced in number? Again, you might privately ask the Chair and Clive about their experience a generation ago—as it were, in terms of municipal history—and the role of the district auditor in crimping the activist authorities of the day. I think it is having in mind somebody who has an interest in the local public good. Again, not to say that private auditors would not have that, but the belief under the previous regime was that district auditors were there, as I said, to carry out a civic purpose. Take that away and—

Ian Swales: We should also remember that although, obviously, we automatically think of fraud, on an 80:20 basis it is incompetence rather than corruption that we are looking at in terms of value for money—it is professionalism and all that kind of thing. Obviously, we get the headline cases but, day to day, it is whether people are doing their jobs effectively and efficiently.

Q125 Mr Bacon: I wanted to ask about the capacity of Audit Scotland, Mr Black, and the references made earlier to the National Audit Office not having a direct connection with the auditors in the same way. Could you just paint a picture for us of the shape and size of Audit Scotland when you were there? How many staff were there and how many were devoted to Scottish Government audit, whether financial or value for money, and how many devoted to local government?

Robert Black: Up until about three years ago, there were roughly speaking—the scale is entirely different—about 200 of us doing financial audit in Audit Scotland.

Mr Bacon: In total?

Robert Black: Yes. My colleagues and I committed ourselves—we could see the way the wind was going with public spending—to a 20% real efficiency saving. By the time I left in June we were well through that, so the financial audit staff numbers had come down to about 160 or something like that.

Q126 Mr Bacon: And of those how many were doing national Scottish Government work and how many were doing local?

Robert Black: There would be a team of auditors who primarily do the Scottish Government resource accounts and who would also do a few of the large agencies. On orders of magnitude, maybe 10 maximum would be in such a team—I am sure that Audit Scotland could give you exact numbers now, because I am not up to date with this. There might be about 50 or 60 of the total staff who were working on overall performance audits, value-for-money audits or best-value reviews of local authorities. About two thirds of all the work, whether financial audit, the best-value reviews of local government or performance audits, was done by in-house staff, and about a third of the audits were done by others.

Q127 Mr Bacon: We are still not clear. Of the 200, or be it 160, how many of them were working on local government issues, whether financial audit or performance audit? You said 50 or 60 but you were talking about the performance audit.

Robert Black: I would encourage you to get a note from Audit Scotland on that, just to be absolutely accurate. Part of the problem was, because we were an integrated organisation, you would actually need to do a time apportionment of where people were working.

Q128 Mr Bacon: Were most people doing a bit of both?

Robert Black: Not most, but a significant number were doing a bit of both. If we were doing, let us say, a major performance review of drug and alcohol policy in Scotland, we would be drawing on people with expertise in health, people with expertise in local government or people working at the centre—people would be working on mixed areas of work with that. So I cannot give an exact figure, I am sorry for that.

Q129 Mr Bacon: The analogy is between Scotland and England, which is roughly 10 times larger and where you have 800 or so staff—slightly less than 850 at the moment, I think—of whom a couple of hundred do performance audit and the other 600 or 650 do financial audit. That is all of central Government and its agencies—none of it is related to local government. There is none of this direct connection that Professor Heald was referring to earlier, so it is all very well to give the National Audit Office a duty, but the question is whether it would have the capacity as presently structured to take on something of that size. If England is roughly 10 times larger than Scotland, at present there is no capacity in the National Audit Office to have this direct connection with local government audit.

Robert Black: May I give you one more piece of information that might be helpful? The budget of Audit Scotland is about £27 million a year. We do all of the work out of that total.

Mr Bacon: The budget of the NAO is about £70 million or £80 million, and that does not include any local at all. It strikes me as unlikely that in its present constitution the NAO would have the capacity to take on all this additional work.

Q130 Chair: What do you feel about that, as it is a key point?

Robert Black: My comment is an obvious one. It would be for the Comptroller and Auditor General with his team to think about relative priorities, in consultation with yourselves. We regularly had to do that with the Public Audit Committee in Scotland, to cut our coat to the cloth.

Q131 Mr Bacon: To use your own phrase it is an order of magnitude difference, if there is all this work that is not going on at the moment.

Professor David Heald: I would argue strongly that that is a matter for Parliament; most directly a matter for the Public Accounts Commission and the Public Accounts Committee, in conjunction with the Comptroller and Auditor General, to think about. We are where we are now, having effectively abolished the Audit Commission, and lost its capacity. The question about where capacity ought to be rebuilt is a

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matter that should be discussed among those parliamentary bodies.

Q132 Chair: We are, but we are interested in your views. Richard Bacon is saying that it is such a qualitatively different set-up. Can the NAO do both?

Professor David Heald: Obviously it can't do it without more budget. That is an obvious point. I find it astonishing—

Q133 Chair: If it has more budget. The interesting thing is that with the National Audit Commission, in a sense we can pre-empt resources. It is for us to determine the budget but it is really whether the magnitude of the task could be fulfilled.

David Walker: Can I briefly echo Richard's point qualitatively? It would need to be a cultural shift of a huge magnitude. The NAO's culture is directed towards Whitehall Departments. Its capacity is not just a volume question; it is an attitudinal question. It would need to think in terms of local service delivery, and think in terms of those strange animals, elected local authorities. That would be a major shift.

Q134 Mr Betts: Would it also be true to say that the NAO tends to look at things totally after the event, to analyse what has happened. The Audit Commission has a more proactive view about trying to anticipate problems and head them off.

Professor David Heald: Mr Black and I were both members of the Financial Issues Advisory Group, which led to the proposals that became the Public Finance and Accountability (Scotland) Act 2000. There was discussion in Scotland about whether one wanted two audit bodies, one for central Government and one for local government. The consensus of the Group was that Scotland wasn't big enough for that purpose.

There is a complex structure in Scotland involving the Accounts Commission and Audit Scotland, which was to take account of sensitivities of local authorities having a separate democratic mandate. I think that issue has come up firmly on the agenda. If the Government are not willing to accept the continuation of the Audit Commission under a name that Richard Bacon thinks of, the question of the role of the NAO has to be thought through. It is not something that should be dumped on the NAO. It should be something that comes out of a parliamentary procedure.

David Walker: But Bob Black has some interesting thoughts about the regionalisation of the NAO, have you not?

Robert Black: Oh, gosh. On the record, David, thank you for that passed ball. I prefer not to go there. There is something in there. To generalise at a philosophical level, there is something very much around the accountability of the auditors to the public. It has always struck me that within England, given the large and complex state it is, there is something about the regional dimension of transparency and accountability to local communities, but doing that in a way that is structured. In other words, for example, the opaqueness and the arcane technology of doing audits are difficult for the public to understand, not least

under IFRS. Therefore, it was a core purpose of Audit Scotland, where possible, to attach meaning and significance to that in lay terms by putting a lot of emphasis on plain English final reports, which were very short form. Of course, that resonates at the level of Scotland, because it is like a large region, so there is something about that lacuna at the sub-national level, but I would prefer not to say more than that.

Jessica Crowe: One way of thinking about it conceptually is to follow the logic of the departmental accountability system statements; that there is one process that is very much the NAO looking at the systems for which the accounting officers in Whitehall Departments are directly responsible. So, in other words, how do they, you as the PAC, and others in Parliament, get assurance about money that is spent at local level, based on local mandates?

Q135 Chair: We are finding it very difficult, I can tell you.

Jessica Crowe: Yes, exactly, but that is what the NAO would need to bottom out to take on this additional responsibility.

Q136 Mr Bacon: The answer we often get is that the question is whether the systems were in place. It is always systemic and always nobody's fault. The issue that would concern the public is if, in the absence of the right regime—I do not pretend to have all the answers to this now—more Doncasters happened, and they did not get known about until it is, as it were, too late. So, they did not get known about until they were already extant and happening, rather than there being an early-warning system. How do you see the installation in the Bill of a sufficient early-warning system?

Jessica Crowe: I am not sure that it can be done just in a Bill about audit, because as I said, I think it is much broader than that. It is worth remembering that the problems of Doncaster go back many years and were brewing up, under the old regime, which we were talking about, with all of its inspection, intervention, monitoring, performance assessment, and all the rest of it. That was all in place and Doncaster still happened, so in a way, you cannot legislate away authorities that are going to get into difficulty, because I think it is all about culture, and the culture and behaviour of an organisation. Organisations have to find a way of instilling the culture.

Research has been done in some private firms into how the top FTSE 100 and FTSE 250 companies work. It is all about the 'tone from the top', as they call it. It is all about how a local authority assesses itself, what local authority members do, and what the chief executive, senior officers and statutory officers do. There may be something more about the powers and roles of the statutory officers, because they are very important. Part of the intervention in Doncaster was absolutely to reinforce the powers and responsibilities of the three statutory officers, because they were what members were effectively ignoring. There may be something around enshrining that, and maybe the triumvirate of the head of paid service, the monitoring officer, and the section 151 officer. That

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then may be a connection to reinforce some of those issues, but it cannot really be done by audit.

Q137 Heather Wheeler: To be honest, I wonder whether you guys are living in a different world, because in terms of the value-for-money stuff and new ways of working, councils get in different types of firms to do those jobs now. If they want to go to KPMG, fine, they can, but it is nothing to do with the audit. Things have been separated out, and you are almost talking as though all that lot still ought to be bunged in together. It is just not like that any more, and that is what the Bill is saying. You seem to be talking from a different era.

David Walker: But there is a link, and the link is the financial numbers. Why auditors became the leaders of value for money was because they were the first and often the only people to see and invigilate the financial numbers. Just coming in and doing VFM, you often will miss the numbers that you are going to need to make a proper assessment. I have no need to draw the Committee's attention to an excellent article that appears in the current edition of "Public Finance" by your expert adviser, Tony Travers, in which he takes us through numbers of missing pieces of data in the system locally, regionally and centrally. One gap, one might say, in the Bill is that data assurance function, which gradually, though not very well, the Audit Commission had been moving into, to at least assure whoever was looking at the numbers that they were there and were meaningful. I think VFM needs somebody to attest to the quality of the financial data coming through.

Q138 Chair: I want to bring Clive in on the savings, but following on from what Heather said, the Bill is there and I suppose the question is what will happen if it goes through unamended.

David Walker: You are going to confront financial disasters. You, us, the public, the taxpayer. Sooner or later. Probably sooner.

Q139 Chair: Financial disasters in local government or in health trusts?

David Walker: Financial disasters in a generic sense that we will not get proper value for money from spending public money.

Q140 Chair: Because?

David Walker: Because nobody owns value for money. Heather is right. There are a lot of people milling around this, but there is no central ownership of the project of squeezing scarce public resources to their maximum, and you are going to get local disasters because there will be failures. Look at the number of people who are qualified to sit on audit panels already, let alone the independent audit bodies. There is a real capacity issue.

Professor David Heald: It will operate at two levels. One is the disaster that the Minister has to explain in Parliament. Second is the more technical difficulty that will be found by accounting officers when accounting whether the money that goes out of central Government to local authorities and health bodies has

actually generated value for money and has been administered with probity.

On my earlier point about the cycle turning, the "Proper Conduct of Public Business" report from 1994 was one of the factors that led up to the accruals accounting revolution in central Government, which led up to Sharman, and the wheel comes full circle. My prediction would be that there will be particular disasters because the early-warning intelligence will have gone, but it will be difficult for central Government Departments that are heavily dependent on distanced delivery organisations to convince Parliament that they have delivered value for money. The Public Accounts Committee will find a loss of information, because when the Comptroller and Auditor General is auditing and concerned with value for money for health and services that are largely delivered by local authorities, there was the infrastructure of the Audit Commission regime there, and that will not be there anymore.

Jessica Crowe: If the Bill goes through as is, the attention then would need to turn to what goes into the regulations to try to make it as safe as possible given the weak statutory thing. I think there are some things that could be done in regulations, and we would just have to fall back on those to see what can be done to put some more safeguards in place.

Q141 Chair: Just to insist on data collection? What are the things that you would put in there?

Jessica Crowe: There are some process things about how you get a robust system at local level for bolstering the independence point. There may be some things that could be done there. It would depend what goes into the code of practice that the NAO puts together that auditors will work to.

Professor David Heald: One of the significant problems is that local authorities get accounts on a UK GAAP basis or an IFRS basis now, and not on what drives council tax. You have the complex reconciliations between the accounting numbers that get audited and the council tax numbers. It is probably not something to be done on the face of the Bill, but one thing that regulation should try to do is to clean up the regime. It seems bizarre that local authorities actually now charge depreciation, but that gets added back and loan charges substituted before you strike council tax. There are all sorts of complications and tensions between the statutory and financial control framework and the actual accounting numbers on which the financial certification is done. That is a fundamental difficulty, because it makes it much more difficult to engage councillors and members of the public when the numbers become so complex that you require a substantial amount of knowledge to actually understand why these adjustments are made.

Q142 Mr Betts: That is an interesting point, because we talk about the public understanding, but my guess is that not 5% of councillors even read the accounts, let alone ask any questions about them. They are just too complicated.

Jessica Crowe: That is the real challenge at the heart of this whole drive towards transparency. If people cannot understand it because it is all so complicated,

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it is not going to achieve that policy objective. There used to be public reporting awards that David and I sat on, but they were dropped.

Mr Bacon: Was this armchair auditor of the year?

Jessica Crowe: Exactly. I wonder why they were dropped, but possibly—

Mr Bacon: Because people turned over to watch Sky Sports.

Jessica Crowe: It is just too complicated. We could not find organisations that were doing it well, because the regime is too complex. It made it very difficult to report.

Q143 Meg Hillier: This may be an unfair question to throw at you, Jessica, but given that you sit at the centre of public scrutiny, do you have an idea of the percentage of councils that do a really good job on financial scrutiny? Scrutiny by its nature can be very hit and miss.

Jessica Crowe: I could not give you a percentage. We know from our annual survey that budget and financial scrutiny is one of the things that scrutiny functions feel that they struggle with. They find it hard to do because of this technical issue. On the other hand, where scrutiny committees are doing well and where they are increasingly moving into is the kind of broader value for money and looking at the outcomes from the spending of money, so not trying to second guess the auditors. We try to tell them not to do that because they are not financial experts. Looking at what the outcomes have been from that expenditure, there are some good examples of where local authority scrutiny functions have found savings of hundreds of thousands of pounds for their local authority. It can be done.

Q144 Mr Betts: I suppose the argument has been—whatever the difficulties and the significant changes—that it will all be all right because £1 billion will be saved by abolishing the Audit Commission. The Audit Commission basically said in evidence to us earlier that the savings that were available will be banked by the removal of the CIA and now the move to the procurement regime that it has adopted, which has found significant savings on audit this time. What would your take be on the Government's claims and the Audit Commission's response that the best savings have been made already?

Professor David Heald: I would be more impressed with the impact statement if it acknowledged the fact that there were some benefits from the assessment regime. The assessment regime was helpful with the long tail of performance and over time, there were significant improvements, bringing councils and other authorities up. The first point is that the Audit Commission spent a lot of money on assessment, but there was absolutely no benefit in it whatever. I do not accept that point. We do not know what the long-term effects on audit prices will be. To go back to my comments to Mr Swales earlier, I actually get worried—I am one of the few people who tend to think that audit fees are too low. You actually get what you pay for. Once you get into a mindset where you want to drive down audit fees without worrying about

whether you are getting the same quality, that can lead to problems in the longer term.

Q145 Mr Betts: There is a bigger problem of that with individual authorities doing their own appointing of auditors.

Professor David Heald: That will become worse, yes. With a central procurement agency, there will be an inbuilt reserve about driving the fees too low. The point I want to make is that people who are not accountants or auditors tend to misunderstand what financial certification audit is about. It is about whether the accounts present a true and fair view of the position of the authority. There are large materiality questions, so lots of things that are wrong would not necessarily be big enough numerically in relation to that authority to be material to the financial statements. The amount of detailed checking that goes on in audits now has gone down dramatically over the years, so people should not expect too much. They are a judgment of a particular point in time about whether there is a true and fair view subject to the materiality issue. They are nothing about economy, effectiveness and efficiency.

Q146 Chair: Does anyone want to add anything to that on the money side?

Robert Black: Simply on that point, if I may. I heartily agree with David Heald that there is a difference between materiality for the purposes of the audit certificate and public interest in some of these things. One could be talking about significant but rather smaller sums of public money, where the public have a right to know and Parliament, whether the Scottish or the UK Parliament, has a right to know whether that money was spent properly. In my past, or in Scotland, that would come in to try and make sure that that was happening, alongside the co-audit.

Q147 Mr Bacon: You bring to my mind two examples, both from financial accounts—one in the Revenue and Customs prosecutions office and one in the Foreign Office—where the amounts of money involved as a proportion of the organisation as a whole were not significant. When the Revenue and Customs prosecutions office, which was the hived off prosecutions department of HMRC, was set up the new director, who knew nothing about HR or finance, appointed a chief operating officer whose first act was to appoint his wife to do £100,000 worth of HR consultancy. This was flagged up in the financial accounts. In the case of the Foreign Office, which was a £2 billion organisation, some satellite phones were stolen in Iraq and were used to telephone betting lines and sex chat lines, and when the bill came in the Foreign Office just signed the cheque and carried on paying the bills. It was £600,000, which was a lot of money but might not have been thought material in light of the size of the Foreign Office. But in each case those examples were flagged up in the financial accounts. So if they are doing their job, should not these things be identified anyway within the financial accounting framework, entirely aside from VFM?

Robert Black: I would like to think that, certainly in the regime of which I was a part, that would happen.

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You would not be guaranteed to identify everything, but I could entertain you for some hours about peccadilloes involving five-figure sums rather than six-figure sums. But the serious point is that these are public interest matters, because these issues resonate with local communities—I need hardly tell you, as elected representatives, of that—and they can be insidious in undermining trust in government as a whole. Trying to find a way to balance this—

David Walker: There is—briefly—another form of criminality, too, which one should worry about, and that is the pursuit of money which is given to contractors. This is something that I know that you on the PAC have been thinking about. What happens when, increasingly, public services are delivered by a variety of bodies inside/outside the public sector—some social enterprises, some for-profit? Does the auditor have the gumption to try and follow the money? Does the auditor have the right to try and follow the money? A proactive public auditor might think, “Yes, I will follow the money.” A private sector auditor might think, “Not me, Guv.”

Q148 Chair: To be honest, I think the public auditor would like to follow the money and says he hasn’t got the statutory authority to do so. That’s the real worry. It is only statutory authority, but this is another thing that the PAC is pursuing.

Q149 Mr Betts: Could you put a right in the Bill?

Q150 Chair: Yes, you could. That is not a bad idea. You could put a right in the Bill to follow the taxpayers’ pound. That is a really good idea.

Jessica Crowe: That is a really important point and something that scrutiny committees have tried to follow and require contractors to appear, but they have been told, “You don’t have the right to call us. We’re accountable to our client and we don’t have to come and account for ourselves in public.”

Q151 Chair: We are coming to an end. I am conscious we have not covered everything, so is there something that you think is key in relation to the draft legislation that you want to draw our attention to?

Robert Black: No.

Professor David Heald: I would just underline this point about data assurance. It is something that, fumblingly, the Audit Commission was getting towards. It is now even more necessary to try and build into an accountability regime.

David Walker: No.

Jessica Crowe: Nothing from me.

Chair: Thank you very much. Those of us that are not on the CLG Committee found that helpful and useful in getting our brain around the issues. I am really grateful to all of you, and particularly grateful to David Heald and to Bob Black for coming down from Scotland.