House of Commons
Communities and Local Government Committee

Audit and inspection of local authorities

Fourth Report of Session 2010–12

Volume I

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

Additional written evidence is contained in Volume II, available on the Committee website at www.parliament.uk/clgcom

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The Communities and Local Government Committee

The Communities and Local Government Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Communities and Local Government.

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Mike Freer MP (Conservative, Finchley and Golders Green) was also a member of the Committee during this inquiry.

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The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/parliament.uk/clg. A list of Reports of the Committee in the present Parliament is at the back of this volume.

The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume.

Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee are Huw Yardley (Clerk), Judith Boyce (Second Clerk), Josephine Willows (Inquiry Manager), Kevin Maddison (Committee Specialist), Emily Gregory (Senior Committee Assistant), Mandy Sullivan (Committee Assistant), Stewart McIlvenna, (Committee Support Assistant) and Hannah Pearce (Media Officer). For this report they were assisted by David Davies (Committee Specialist).

Contacts

All correspondence should be addressed to the Clerk of the Communities and Local Government Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 1234; the Committee’s email address is clgcom@parliament.uk
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The Government has announced the abolition of the Audit Commission and substantial changes to the way in which audit of local government is to take place. It has already terminated comprehensive area assessment (CAA) as part of its commitment to cutting inspection of local authorities. These changes raise significant questions of principle and implementation in regard to public audit and performance management.

Until now the Audit Commission has been the regulator, commissioner and major provider of local government audit services. Under the Government proposals, local authorities will, via independent audit committees, have responsibility for appointing their own auditors. Some of the Audit Commission’s functions—responsibility for drawing up the scope of audit (the Code of Audit Practice) and for national value-for-money studies—will pass to the National Audit Office (NAO). Other functions will transfer to other bodies or cease entirely.

The changes are part of the Government’s localism agenda, devolving powers to local government and a move away from the “command and control” approach that, the Government argues, has characterised central-local government relations over the past decade.

It is clear that these proposals involve both opportunities and risks. We heard concerns that some fundamental principles—particularly that public bodies should not appoint their own auditors—were being breached. However, on the advice of the Comptroller and Auditor General, we are prepared to accept that the vital principle of auditor independence can be safeguarded, provided that adequate legal and practical arrangements are put in place. We emphasise the heavy responsibility this places on the Government and the NAO to ensure that the new system delivers the key objectives set out in the Department for Communities and Local Government’s consultation document. Devolving powers to local government means that central government must ensure that it first establishes an audit framework that is effective, efficient and robust.

The Government intends to introduce a public audit bill in the autumn. This will provide the proper opportunity for scrutiny of the detailed proposals. In our Report, we set out the principles that we believe should govern public audit arrangements in the future, including:

- Auditor independence must be strictly maintained;
- Local audit committees must have a majority of independent members;
- Additional safeguards are needed to ensure the continued effectiveness of public interest reporting, and
- The scope of local government audit should be proportionate and risk based. It should allow for local innovation and application, particularly with regards to local value for money work.
If local audit committees are to have a choice of audit provider, a competitive audit market will be crucial. Presently the Audit Commission undertakes 70% of the local government audit; the remaining 30% is undertaken by five private audit firms, under contracts with the Audit Commission. The Audit Commission audit practice is to become a stand-alone body, able to compete for local government audit work. We recommend that the Government assist the Audit Commission audit practice over this transitional period so as to ensure that its audit skills are not lost and that it continues as a major player in the public audit sector. There are already too few audit firms in the public audit market. We would be firmly opposed to one of the “Big Four” firms taking over the Audit Commission. Our favoured outcome is the establishment of a stand-alone company, preferably a mutual.

The end of CAA and inspection was widely welcomed by local government and others. An over-burdensome inspection regime seems to have been the principal reason why the Audit Commission lost the support of its local government stakeholders. (Its work as auditor is still held in high regard.) Local government will no longer be required to submit performance indicators to government. The responsibility for driving improvements in service standards and efficiency will lie with local government and “armchair auditors”. Consequently there will be a lack of comprehensive, consistent data on which authorities can be compared. We recommend that the need for and adequacy of comparative performance data be reviewed two years from now, once the new arrangements have bedded in.

We accept that the time for centrally-prescribed inspection of local government services and governance has passed. We welcome the LGA’s proposals for sector-led performance management. We reiterate the call in our Localism report for the Government to examine the role which robust local government scrutiny arrangements could make to improving local government performance. The Government needs to clarify arrangements for intervention in the exceptional cases of serious corporate or service failure.

The manner in which the Audit Commission’s abolition was announced and progressed may have resulted in a missed opportunity for what could have been a valuable reassessment of the arrangements for public audit. In the short term, the Government should concentrate on successful implementation of the changes it proposes. Once new arrangements are in place, we recommend that the Government instigate a wide-ranging review of public sector audit and how it fits into the wider context of accountability for the expenditure of public money.
1 Introduction

1. The audit and inspection of local authorities may not sound like a topic to set the pulse racing. Yet for the past decade and more it has been at the heart of the relationship between local and central government. Whitehall has wanted assurance that its substantial increases in funding for local government were resulting in the outcomes that it was seeking and not being consumed in increased costs and inefficiencies. Best value duties, targets, performance indicators, local public service agreements, “Gershon” efficiency savings and other mechanisms were introduced to direct, ‘stretch’ and compare the performance of local councils. These were backed up by audit and inspection.

2. The Audit Commission was the principal player in this field. As the audit regulator, commissioner and provider of local authority audit in England, the Audit Commission shaped and undertook local government audit. As principal local government inspector, it both carried out the instructions of Government—mainly but not exclusively for Department for Communities and Local Government (DCLG)—and also shaped the landscape within which it, the Audit Commission, operated. Its methodology started with best value inspections of individual services, moved to comprehensive performance assessment (CPA) of councils, and culminated in comprehensive area assessment (CAA) of councils and their local public sector partners.

3. On 13 August 2010, the Secretary of State for Communities and Local Government, Rt Hon Eric Pickles MP, announced the abolition of the Audit Commission. Local authorities would be given responsibility to appoint auditors of their choice. The Audit Commission’s audit practice—the fifth largest audit practice in the UK—would become a stand-alone business that would have to compete against the private sector for audit work. Other functions of the Audit Commission would cease or pass to other bodies, including the National Audit Office (NAO) and the professional audit bodies.

4. The Government subsequently published more detailed proposals for local government audit arrangements in a consultation paper, Future of local public audit: Consultation. This paper excluded proposals for the Audit Commission audit practice and certain other functions undertaken by the Audit Commission, such as the National Fraud Initiative and national value-for-money (VfM) studies.

5. The proposals for reform of the audit and inspection of local authorities give rise to fundamental questions about both the principles and practicalities of public audit, the relationship between local and central government, and the best mechanisms to bring about improvements in local government services. Some of our witnesses clearly felt that fundamental principles had been breached. Others were of the view that the principles could hold provided adequate safeguards were put in place. We address these issues of principle in our report. The Government has said that it intends to publish a draft Bill for

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1 Department for Communities and Local Government: Eric Pickles to disband Audit Commission in new era of town hall transparency, press notice, 13 August 2010
pre-legislative scrutiny later this year. This will be the appropriate opportunity to address finer points of detail; we trust that whichever Committee carries out that scrutiny will consider the Bill carefully in the light of the conclusions and recommendations of this Report.

6. We are grateful to the organisations and individuals who provided evidence to our inquiry. We were advised throughout by Ron Hodges, Professor of Public Services Accounting at the University of Sheffield, and Gillian Fawcett, Head of Public Sector at the Association of Chartered Certified Accountants.

3 Ev 228

4 Professor Ron Hodges declared the following interests: Professor of Accounting at the University of Sheffield (paid), Member of the ACCA International Public Sector Technical Committee (unpaid), Member of the CIMA Research Board (unpaid), Treasurer and Trustee of the British Accounting Association—a registered charity (unpaid), Director and Trustee of Gedling Homes—a registered charity (unpaid), Member of Finance Committee of the New Charter Housing Trust Group (unpaid), I have conducted research work with numerous other researchers in various public sector organisations (these are all temporary projects and have not involved funding from the organisations themselves).

Gillian Fawcett declared the following interests: April 2009–to date: Head of Public Sector for the Association of Chartered Certified Accountants (ACCA), Up until 2006: senior policy advisor with the Audit Commission, ACCA has commissioned some research with the New Local Government Network (NLGN) which is focusing on the same areas as the Committee’s inquiry.
Abolition of the Audit Commission

Localism context

7. The decision to abolish the Audit Commission was not widely anticipated, although the wider context had been established. The May 2010 Coalition Agreement of the incoming Government contained a commitment to devolve power from central to local authorities and local communities and to end inspection of local authorities by the Audit Commission:

We will promote the radical devolution of power and greater financial autonomy to local government and community groups.

We will cut local government inspection and abolish the Comprehensive Area Assessment. 5

8. Accordingly, on 25 June 2010, the Secretary of State for Communities and Local Government, Rt Hon Eric Pickles MP, instructed the Audit Commission immediately to cease work on CAA, which it did. The end of CAA was welcomed by the Local Government Association (LGA); 6 it would also save DCLG the £28 million a year grant that it paid to the Audit Commission for CAA. With the contentious issue of CAA removed, it might have been assumed that the Audit Commission would be left to continue its historic core functions of local government auditor and national value-for-money (VfM) studies. This was not to be.

9. DCLG Ministers justified the decision to abolish the Audit Commission on the grounds that an Audit Commission which was regulator, commissioner and provider of local government audit services was highly “centralist” and thereby incompatible with the Government’s move to localism. 7 8 In addition, “Ministers believe that the work of the Commission has increasingly become less focused on accountability to citizens and more on reporting upwards to Government, judging services largely against top down Government imposed targets.” 9 Local government minister Grant Shapps MP also argued that abolishing the Audit Commission was a simplification of the audit arrangements and removed duplication 10—a view shared by few of our witnesses.

Abolition and fragmentation

10. The Government and witnesses made clear that, as an auditor, the Audit Commission was respected. Nonetheless, many of our witnesses accepted that it was unusual for a body

6 Ev 136
7 Q 521
8 The Committee expressed its support for the principles of localism but concerns about aspects of implementation in its recent Report: Localism, Third Report of the Communities and Local Government Committee, Session 2010–12, HC 547, 7 June 2011
9 DCLG: Eric Pickles to disband Audit Commission in new era of town hall transparency, press notice 13 August 2010
10 Q 600
to fulfil all three functions of regulator, commissioner and provider of (audit) services and that a separation of these functions was a reasonable move. With regard to its inspection and its VfM functions\textsuperscript{11}, there was less sympathy: “the Audit Commission had lost its way”\textsuperscript{12} and “lost its stakeholders”\textsuperscript{13} too.

11. We asked Amyas Morse, the Comptroller and Auditor General (C&AG), as the country’s senior public auditor, whether abolition was in line with best audit practice and value for money. He told us it was a “policy-driven decision” and that the proposals were “different but practicable”:

> In this case, it was pretty clear, as soon as we became aware of this, that it was a policy-driven decision. It wasn’t a question of merit or demerit. Then if I add my private comment to that, while I have a lot of respect for and good relationships with many in the Audit Commission, I think that both the Audit Commission arrangements have pluses and minuses to them and, as a matter of fact, I think that the proposals being put forward are also practicable—different but practicable.\textsuperscript{14}

He stressed that the implementation “need[ed] rigorous attention”.\textsuperscript{15} Like the Chairman of the Audit Commission,\textsuperscript{16} he had not been consulted beforehand on the principles and was “aware of it shortly beforehand”.\textsuperscript{17}

12. David Heald, Professor of Accountancy at the University of Aberdeen Business School and Steve Martin, Professor of Public Policy and Management at the University of Cardiff, criticised the process as “not evidence-led”.\textsuperscript{18} David Walker, former Managing Director of Communications and Public Reporting for the Audit Commission also endorsed this view. Other witnesses, notably the late Dame Barbara Mills, Chair of the Professional Oversight Board, Financial Reporting Council (FRC) and some of professional audit bodies,\textsuperscript{19} regretted that the option of a residual Audit Commission had been effectively ruled out by the summary announcement of the Commission’s abolition. The Audit Commission themselves favoured this option. Whilst it was cooperating in the development of the new audit arrangements, its chairman said “at the moment our instincts are that the whole will be less than the sum of the parts.”\textsuperscript{20}

13. There were those who argued that retaining the Audit Commission and central control of audit could be seen to support localism where a multiplicity of providers and devolved budgets might make it difficult for devolved audit arrangements to account for public

\begin{footnotesize}
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  \item \textsuperscript{11} Value for money work forms part of the audit; in addition the Audit Commission undertakes national research studies—often referred to as vfm studies.
  \item \textsuperscript{12} Q 520 Shapps
  \item \textsuperscript{13} Q 2 Professor Heald
  \item \textsuperscript{14} Q 468
  \item \textsuperscript{15} Q 476
  \item \textsuperscript{16} Qq 206–207
  \item \textsuperscript{17} Q 464
  \item \textsuperscript{18} Q 1
  \item \textsuperscript{19} Q 457 The ACCA and CIPFA witnesses expressed similar views.
  \item \textsuperscript{20} Q 208 Eugene Sullivan
\end{itemize}
\end{footnotesize}
money.\textsuperscript{21} A detailed recent study into the Government’s proposals by the New Local Government Network (NLGN), while accepting the new proposals, pointed out the risks:

While the aims—reduced cost, stronger local accountability and choice—seem clear, risks loom large. A failed regime may see costs rise, [and] undermine trust in government and indeed in the concept of localism.\textsuperscript{22}

14. A number of our witnesses, including the Chair of the Professional Oversight Board, FRC,\textsuperscript{23} were concerned that the proposals would result in more fragmented audit arrangements, not only within local government but adding to the complexity within public audit generally, with a myriad of audit arrangements across local government, health and other local public bodies. The proposals also contrast strongly with audit arrangements for central government, where the NAO is the external auditor for all departments, undertakes the VfM studies and contracts out less than 20% of its work to private audit firms.\textsuperscript{24} These concerns chime with matters recently discussed by our colleagues on the Public Accounts Committee, who have considered and are continuing to consider issues of accountability raised by “[...] reform and localism proposals which envisage a significant devolution of responsibility for service delivery to a wide range of new bodies, in some cases independent of both central and local government”.\textsuperscript{25}

15. Professor Heald argued strongly that, since the established principles of public audit had been challenged, the time had come for a thorough review of public audit by Parliament, including the role of the NAO:

There are some fundamental issues about public audit that Parliament has to deal with. I think the abolition of the Audit Commission has thrust those on to the agenda in a way that might not otherwise have happened. [...] There has been a fundamental failure by Government in terms of the review of the Audit Commission. The other issue is that Parliament has also failed in the context of thinking about public audit. The issue about the status of the National Audit Office has been on the go for two and a half years. [...] I think that now Parliament almost accidentally has come to a point when those issues cannot be avoided any longer.\textsuperscript{26}

16. Although Government acknowledges the distinct principles of public sector audit, there also appears to be an underlying belief that the system used for company audits will be appropriate for local government audit. The Chief Executive of the Audit Commission said that there had been “no real debate” as to whether the Companies Act regime was appropriate for public sector audit.\textsuperscript{27} The move towards greater commonality between public sector and company audit is supported by the FRC.\textsuperscript{28} Yet the system for company

\textsuperscript{21} Q 265
\textsuperscript{22} NLGN, Show me the money—accounting for localism, April 2011, p 6.
\textsuperscript{23} Q 452
\textsuperscript{24} Qq 510–514
\textsuperscript{25} Twenty-eighth report of the Public Accounts Committee, Session 2010–11, Accountability for public money, HC 740, Summary.
\textsuperscript{26} Q 2
\textsuperscript{27} Q 211
\textsuperscript{28} Ev 223
Audits is receiving intense scrutiny from a number of bodies including the European Commission, the FRC and the House of Lords Economic Affairs Committee. Directly replicating the company audit model may bring additional risks—such as the lack of powers of the FRC as lead regulator—as a result of fragmentation of the system.

17. **We accept that sometimes policy-led decisions have to be made quickly and without lengthy prior evaluation and consultation.** The decision appears to have been taken without a clear evidence base. There is potentially an opportunity for a valuable reassessment of the arrangements for public audit. The Government has also effectively ruled out consideration of the potentially useful option of retaining a residual function for the Audit Commission, which may have presented an opportunity to prevent the fragmentation of functions.

18. **We are now some way down the road of the abolition of the Commission, and, as we report below, further delay in finalising arrangements could jeopardise the chances of a smooth transfer of its audit practice into the private sector.** In the short term, therefore, the Government should concentrate on successful implementation of the changes it proposes. Nevertheless we are critical of the manner in which this major policy change has been handled, and the missed opportunities which have resulted. Once new arrangements are in place, we recommend that the Government instigate a wide-ranging review of public sector audit and how it fits into the wider context of accountability for the expenditure of public money. Such a review should be carried out in close consultation with Parliament, in particular through the relevant select committees.

**Savings from abolition of the Audit Commission**

19. The press notice announcing the abolition of the Audit Commission suggested that it would result in savings to the taxpayer of £50 million a year:

**Save the taxpayer over £50 million a year:** This will include saving the central and corporate costs of the Audit Commission, currently paid for by the Commission’s fees including a surcharge on audits, including those by private firms. In addition, councils will be able to appoint their own independent external auditors from a more competitive and open market among audit firms, reducing costs.

20. The local government minister was reluctant to divulge further details to us but insisted that the figure was likely to be even higher:

**What I can tell you is that there is nothing that I have seen since the announcement of the abolition and the headline £50 million figure that leads me to suspect that the number is any smaller.** In fact, the more you look into this, the more you see how

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29 The House of Lords Inquiry criticised the current regulatory arrangements for listed companies as being fragmented: regulation is shared between the overlapping professions with a limited role for the FRC. The accountancy professions have responsibility for both investigating complaints against their members and, where necessary, disciplining them. The FRC is seeking a strengthened role to licence firms and to perform interventions. House of Lords Select Committee on Economic Affairs (2011), *Auditors: Market concentration and their role*, HL Paper 119-I, par. 106–108.

30 See Chapter 5

31 DCLG: *Eric Pickles to disband Audit Commission in new era of town hall transparency*, press notice, 13 August 2010
money is being spent by the Audit Commission—£18,000 on bespoke photography for the launch of the report into the comprehensive area assessment, for example—there is nothing that does not lead you to think that you could save a lot of money by abolishing it.\(^{32}\)

21. The Minister presented no detailed evidence of how the £50 million saving would be achieved. In any event, the £50 million figure has been challenged by the Audit Commission, which says the cost of redundancy payments resulting from abolition is already £27 million and will rise to between £40 million and £105 million. £56 million has been set aside for the costs of Audit Commission abolition in the DCLG Main Estimate 2011–12, May 2011. In addition, there will be £15 million for early termination of leases. Pension liabilities would be additional and depend on whether or not the Audit Commission continues to be classified as a going concern. The CEO pointed out that £30–35 million—70% of the savings sought—had already been achieved through the curtailment of some of its functions, notably CAA, and that the Audit Commission had implemented an efficiency programme.\(^{33}\)

22. It is not clear to us that significant savings will result from abolition of the Audit Commission, at least in the short to medium term. There is a huge discrepancy between the £50 million savings cited by the Secretary of State and the figures provided to us by the Audit Commission. Some costs will be transferred to other bodies, including the NAO\(^{34}\) and local government audit committees. Costs transferred to private sector firms and professional audit bodies will be recharged to local government in audit fees.

23. The overall impact on local government costs is also unclear. There will be savings from the reduced burden of inspection\(^{35}\) although these could have been achieved without wholesale abolition of the Audit Commission. The wider impacts on local government of deregulated audit fees are unclear but potentially significant. We address these in chapter 5.

24. DCLG should demonstrate its commitment to transparency by reporting and monitoring annually for the next five years on the full savings and costs in respect of: the abolition of the Audit Commission and the tasks transferred to other bodies, and how these compare with costs under the existing system.

Armchair auditors

25. In his announcement of the abolition of the Audit Commission, the Secretary of State suggested that “armchair auditors” would in future hold local government to account:

These proposed changes go hand in hand with plans to create an army of armchair auditors—local people able to hold local bodies to account for the way their tax pounds are spent and what that money is delivering.\(^{36}\)

\(^{32}\) Q 532

\(^{33}\) Q 217 Sullivan

\(^{34}\) The C&AG estimated the costs to be “a few million a year....less than five” Q 495

\(^{35}\) See Chapter 6

\(^{36}\) DCLG PN
26. Although a few witnesses, such as the TaxPayers’ Alliance, were enthusiastic about the armchair auditor concept, most of our witnesses were doubtful that members of the public would have the time or capacity to obtain and analyse data to the extent that an official auditor or inspector might. David Walker suggested that armchair auditors might usefully ask about value for money but their role should be distinguished from that of the professional auditor.37 Professor Martin made a similar point regarding inspection.38 There were also concerns that the publication of raw financial data—such as all items costing over £50039—would not have adequate context for meaningful assessment. Professor Heald suggested that there might be a focus on minutiae instead of on the bigger picture.40 There was, however, an acceptance by local government witnesses that greater transparency in council spending was the right and proper path, that requests for information were not unduly burdensome, and that publication had a useful ‘disciplinary’ effect on spending decisions.

37 Ev 120
38 Ev 129
39 As part of the Government’s transparency agenda, the Secretary of State has required local government to publish details of all expenditure over £500.
40 Q 33 Professor Heald
3 Auditor independence

Principles of public audit

27. Independent audit of local government and other local bodies responsible for public funds has existed in England for over 150 years. The District Auditors’ Society emerged in 1846 followed by the District Auditors Act 1879. Over this period, principles of public audit and the ways in which it differs from private sector audit have been established. These principles were codified by the Public Audit Forum in 1998 and endorsed by Lord Sharman’s report of 2001:

- auditors are independent of the audited body;
- the scope of auditors’ work covers not only the audit of financial statements, but also ‘regularity’ (legality), propriety (probity) and use of resources (value for money), and
- auditors may report widely to the public, councillors and other key stakeholders.

28. Our witnesses, from both public and private sector, agreed that the principles should be retained in any future audit regime because there are unique features which need to be taken into account for the sector including:

- the political nature of local government;
- the need for local and national accountability;
- that taxpayers are obliged to pay council tax and cannot switch their investments and custom as in the private sector; and
- the absence of a profit motive to drive efficiency and improvement.

29. The Government says that, in framing its proposals, it has “had regard” to the principles of public audit. Our witnesses were divided between those who felt that the Government proposals breached the fundamental principles and those who believed that the principles would be retained provided that adequate safeguards were put in place.

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41 The Public Audit Forum is comprised of the five public audit agencies in the UK: the National Audit Office; the Audit Commission; Audit Scotland; the Northern Ireland Audit Office; and the Wales Audit Office.


43 For example, Ev w45

44 DCLG Consultation paper para 1.19
Local appointment

30. The most contentious aspect of the Government proposals is that local authorities should become responsible for appointing their own auditors. Professor Heald was strongly opposed:

[...] what worries me most about the evidence I have seen is the lack of recognition that it is a fundamental principle of public audit that public bodies do not appoint their own auditors. That was categorically established at the time of Sharman […]. The Government appointed Sharman and then accepted his conclusion. That was really the high point of the principle that public bodies do not appoint their own auditors. That principle was breached at the time of the creation of foundation trusts […]. What people ought to have seen then was that this would become a rolling stone, and now it is local authorities. 

31. The Government is proposing that each council should establish an audit committee, with an independent chair and substantial representation of independent members, to ensure that auditor independence is protected. There would be requirements for transparency regarding the recommendations of the Audit Committee and the auditor. The Secretary of State would have reserve powers to act if, for example, a council failed to appoint an auditor. The Government also points to the existing legal and institutional framework protecting auditor independence in both public and private sectors.

32. The Audit Commission witnesses accepted that there was a debate to be had about whether the Government’s proposals constitute a breach of the principle of auditor independence if adequate safeguards are put in place. It favours retention of independent appointment but is engaging with the Government and others in development of safeguards for local appointment.

33. The LGA supports the proposals and believes that independence can be maintained. It questions why local government should not be trusted with this responsibility when foundation trusts, universities and further education colleges currently appoint their own auditors; and it is proposed that Academy schools should also. In the LGA’s view, local appointment would also enable local government to obtain better value from its audit through more locally-specific arrangements. The NLGN concludes: “In principle there is a strong argument for giving local authorities greater control over their own audit processes. […] In practice there are also strong grounds for localising audit processes.”

45 After our evidence sessions concluded, DCLG announced that those local authorities for whom the Audit Commission was the audit provider would be able to appoint their own auditors starting in 2012/13. DCLG: Developing options for the most effective transfer of the Audit Commission, press notice, 2 June 2011.

46 Q 8
47 Q 208
48 Q 211
49 Ev 135
50 Q 23 Walker
51 NLGN, Show me the money—accounting for localism, April 2011, p 29
34. We have set considerable store by the opinion of the C&AG, who has responsibility for auditing the Whole of Government Accounts and who would be concerned by weaknesses in local government accounting. The view of the C&AG was that, given adequate safeguards, auditor independence can be maintained with local appointment. He told us it was a matter of implementation, not principle:

The principle is independence. I have thought carefully about this, because I guessed that you might ask me these questions—and quite rightly, too. In my view, the question is, is the appointment independent? That is the question. It is not a principle that it must appointed by a public or an external body. If you get the right arrangements in place, I believe it is possible to get independent appointment, because through the consultation process we could come to a viable set of independent appointment criteria.52

35. We also emphasised to the Minister the need to safeguard auditors from unreasonable dismissal.53

36. The legal framework for and practicalities of local audit committees are of crucial importance to the success of the proposals. The Government is consulting on the eligibility criteria for independent members of audit committees and whether they should be in the majority. Details would be included in the proposed public audit Bill. Concerns were raised about the capacity of some local authorities to find sufficient suitably-qualified independent members to chair and serve on local audit committees. These concerns were played down by the minister:

About 80% of authorities already have some type of audit committee—not necessarily independent ones; possibly 50% could be classed as independent. I read some evidence to the Committee suggesting that there simply are not good people out there who would be willing to come forward. That is not my experience in local government.54

37. The Government is proposing a departure from the established practice that public bodies should not appoint their own auditors. The proposals place a great responsibility on the Government to create adequate legal safeguards and assist local government in establishing local audit committees that are, and are seen to be, capable and independent. Advice, training and resources will be required. The National Audit Office, on whose evidence we have placed considerable weight, must also ensure that the system succeeds.

38. The legislation will have to provide clear and uncontestable protections for assuring the independence of audit committees and auditors. We recommend that final responsibility for appointment of the auditor should lie with the full council, following a recommendation of the audit committee. Dismissal of the auditor should also be a decision for full council, following the recommendation of the audit committee. The regulations should provide a ‘double lock’ so that neither body is allowed to dismiss the

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52 Q 477
53 Qq 555–558
54 Q 549
Audit and inspection of local authorities

39. Audit committees must be chaired by independent persons of proven competence, and should have a majority of independent members. These requirements (including the avoidance of conflicts of interests for independent members) should be defined in law. Chairing of audit committees will be a significant responsibility and should be remunerated, and allowances should be payable to other independent members. The law should require full transparency for audit committee proceedings.

Public interest reporting and objections to accounts

Public interest reporting

40. Public interest reports (PIR) are produced by the auditor where there are grounds for believing, for example, that a local authority has wasted significant amounts of money through poor governance or acted outside its legal powers. These reports can bring the auditor into conflict with the local authority. Public interest reporting is an essential element of public sector audit which does not feature in private sector audit. The DCLG consultation accepts this and proposes that public interest reporting continue to be a responsibility of the local auditor.

41. The Audit Commission has issued 131 PIRs since 2002. A number are for relatively minor issues, such as non-publication of accounts by moribund parish councils. However, some PIRs have dealt with important and highly controversial cases, which have sometimes been strongly resisted by the council or public body concerned. The most protracted, costly and high-profile case was the report of the district auditor into Westminster City Council, which concluded that senior councillors, including the leader, Dame Shirley Porter, had misused public money by selling council homes in order to influence voting patterns. This took 14 years (from 1987 to 2001) and was finally settled in the House of Lords on appeal by the Audit Commission. Although PIRs are relatively rare, they are seen as a vital component in the public auditor’s arsenal to ensure that public bodies address their responsibilities and ultimately to “keep them honest”.

42. Under the Audit Commission, district auditors—both Audit Commission staff and private audit firms—have demonstrated their capacity to undertake PIRs and to pursue objections by the public. The concern is that, under local appointment and without the backing of the Audit Commission, auditors may be less inclined to instigate a PIR. CIPFA questioned whether “difficult conversations” between auditor and council would take

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55 DCLG Consultation doc 4.27
56 Between April 2009 and December 2010, auditors issued public interest reports to 58 parish councils. Most reports related to the failure to produce, or provide sufficient evidence to support, the annual return. (Audit Commission 24 February 2011)
57 For example, Lincolnshire County Council (2002), Merseytravel (2008) and Doncaster (2008).
58 Although a PIR was also published, the inquiry was prompted by public objections to the accounts in July 1987. See Follow the money, p 341 and Qq 383–393.
59 Q 383
60 Mr John McGill, the district auditor who undertook the Westminster report, was a partner with Touche Ross.
43. Some audit firms were not convinced that PIR would be feasible under local appointment. Professional bodies CIPFA and ACCA also expressed serious doubts. Deloitte and ICAEW suggested that a review was needed to narrow and clarify the auditor’s responsibility. The Minister, however, believed that the current duties and safeguards were adequate.

44. The Government has proposed that arrangements for public interest reporting continue without additional safeguards. However, the abolition of the Audit Commission as overseer and guarantor of public interest reporting represents a fundamental change to this aspect of local auditor appointment. Therefore changes are required to the Government’s proposals to safeguard public interest reporting, as indicated by several witnesses. These should include an explicit requirement in the duties specified for the audit committee in the primary legislation to support the auditor in any reasonable recommendation for a public interest report; and the professional oversight body (or bodies) responsible for accrediting auditors for local government audit work, should be specifically required to consider the competency of firms to undertake this role and to monitor the standard of public interest reporting undertaken. In addition, the oversight body should be given powers to appoint a separate organisation to undertake the investigation and report, where necessary.

**Right of objection**

45. The public has a statutory right to inspect and formally to object to local government accounts. The district auditor must decide whether to take any action; they will normally give reasons for their decision. The view of most of our witnesses was that too many objections were unjustified and vexatious, often incurring excessive costs which were then charged to the local authority. Mr Johnson of Deloitte explained that, in his experience, objections caused the auditor more problem than public interest reporting as the former were often of a quasi-judicial nature. The Audit Commission cited a case relating to Barnet Council which cost over £1m to investigate. The Audit Commission and other witnesses recommended limiting the statutory right to object and to allow the district auditor discretion over how to deal with objections. An alternative suggestion was to channel complaints to the local audit committee or to the local authority s151 officer who could then decide whether to refer them to the auditor. The Government is proposing changes to the rights to object to accounts of smaller bodies (those with expenditure or income under £6.5 million a year). The right to object would be amended so that the
objection is made to an independent examiner who would decide whether to refer the issue
to the ‘proper officer’ of the district or county council.69

46. The statutory right of the public to object to accounts should be replaced by more
proportionate arrangements. We recommend that, for larger bodies, objections be
investigated by the s151 officer, who would inform the local audit committee and
auditor of the objection and the investigation. The auditor would be free to decide
whether it merited further attention and, if so, by whom. The public’s rights to inspect
accounts and to ask questions of the council would remain.
4 Audit scope

Responsibility for the audit code, standards and consistency

47. The scope of local government audit is set out in a code of audit practice which is drawn up by the Audit Commission and approved by both Houses of Parliament at five-yearly intervals. Auditors have a statutory duty to comply with it.\(^\text{70}\) The Government has proposed that the NAO take on the role of producing the Audit Code. The C&AG told us that the NAO was willing and able to do so;\(^\text{71}\) this would cost “a few millions”.\(^\text{72}\) The cost would accordingly be met by Parliament whereas currently it is borne by DCLG and local government, although it makes little difference to taxpayers. In the absence of the Audit Commission, our witnesses accepted that the NAO was the organisation best placed to fulfil this task, but it was noted that the NAO would lack the close engagement with local government that made the Audit Commission so well-placed for the task.

48. The Government’s consultation document asserts that “higher standards of auditing” is a key design principle of its proposals.\(^\text{73}\) It proposes that the FRC take on responsibility for overall monitoring of quality in local government audit, with roles for the recognised supervisory bodies.\(^\text{74}\) The FRC already fulfils this function for the private audit sector and has had some recent involvement with public audit. It is seen as an effective and even ‘ferocious’ regulator.\(^\text{75}\) Nigel Johnson of Deloitte told us that consistency was likely to be a bigger issue than quality. Without the Audit Commission and with a greater diversity of audit providers, a new mechanism would be needed to enable and promote discussion, coordination and advice. This would imply a proactive role which is not addressed in the Government consultation. It seems logical that, if the NAO is made responsible for producing the audit code, it should lead on ensuring consistency of application. However, without direct regular involvement in local government audit, the NAO is likely to need to involve others, such as the FRC, professional bodies and the LGA, in the process.

49. We agree that the NAO is best-placed of the remaining bodies concerned with public audit to prepare the code of audit practice. It should do so in conjunction with the LGA, professional accountancy bodies and other appropriate stakeholders, who should be made statutory consultees. Ensuring consistency in audit is a related task, and key matter, responsibility for which has not been specified. The Government must clarify how consistency in audit is to be achieved before the new system is introduced.

50. In preparing the code of audit practice, the NAO will—subject to the approval of the Public Accounts Commission—incur additional costs, and may have to build capacity to fulfil these functions. We invite the Public Accounts Commission to monitor costs.

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\(^{70}\) Ev 163

\(^{71}\) Q 491

\(^{72}\) Q 495

\(^{73}\) DCLG Consultation doc para 1.17

\(^{74}\) DCLG Consultation doc par. 2.23–2.25

\(^{75}\) Q 518
and seek to ensure that they do not exceed those previously incurred by the Audit Commission.

Scope of audit: key elements

51. As noted earlier, it is an established principle that audit for public bodies requires a broader scope than audit for private companies. It includes not only the audit of financial statements, but also ‘regularity’ (legality), propriety (probity) and use of resources (value for money). Our inquiry showed no dispute about the need for the audit of financial statements—the auditor’s “true and fair view” opinion. However, in the view of some of our witnesses, the audit scope is too broad and some elements, particularly value for money in audit (local VfM work), should be reduced or even dispensed with:

[...] the professionalism of auditors lies in financial probity, regularity, and fair and true assessments. Let’s try to keep them on that track and strip away what has accrued over the past 25 years—certainly during the lifetime of the Audit Commission—with the wider effort to subject them to a performance management regime on the one hand and value for money on the other.

The LGA wanted to see not only the VfM element removed, but also the financial resilience element, and a more proportionate approach to grant claims certification. A further view of some in local government was that the audit code was too prescriptive and not what some councils needed—a one size fits all. The NAO appeared to support the view that the code could be better focused and more responsive to local circumstances. At the same time, the audit firms wanted the code clearly specified so that bidding would be on a fair basis and local authorities would not be able to omit elements of the code and auditors would be clear what was required of them.

Value for money in audit

52. The value for money element of the audit code is by far the most contentious. The NLGN study found “some support for a more in-depth audit scope including VfM” but “a much more significant level of scepticism as to the benefits it provided against its costs.” NLGN’s recommendation is to “reduce the compulsory level of audit, with councils voluntarily able to upgrade to VfM surveys.” Grant Thornton proposed that VfM should remain a part of the audit code but local authorities should have a greater say in determining the scope of VfM audit.

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76 The Audit Code of Practice specifies that some value for money work be undertaken as part of the audit. This “local VfM work” is distinct from the national value for money studies undertaken by the Audit Commission, which are addressed in Chapter 7.
77 Q 15 David Walker
78 NLGN, Show me the money—accounting for localism, April 2011, p 53
79 Q 498
80 Q 398
81 NLGN, Ibid, p 53
82 NLGN Ibid, p 60
83 Ev w45
53. “Value for money” seems a simple, almost unimpeachable concept—a balance of quality and cost—but it can be interpreted in a number of ways and can be very difficult to define in practice. Nigel Johnson of Deloitte noted that it can be highly technical matter, requiring specialist staff, and one that auditors were not necessarily equipped to undertake. David Walker and Gervase Macgregor of accountancy firm BDO argued that VfM involves value judgements which were matters for councillors and electors, not auditors. Professor Seddon, Managing Director of Vanguard consultancy, suggested that too much VfM work had involved the promotion of pre-determined solutions (shared services, contracting out “back office” functions, call centres etc) which were not necessarily appropriate and had often led to increased costs and poorer service.

Financial resilience and grant claim certification

54. The assurance that an organisation is a ‘going concern’ is a fundamental part of financial audit in both public and private sectors. The LGA, however, wanted to see the financial resilience element removed from the audit code. It objected to the broad definition of financial resilience that has been applied of late, “ie. having proper processes in place to continue to operate for the foreseeable future and manage potential financial risks and opportunities.” Other witnesses argued against this: in this period of cuts, financial survival should have higher priority in the audit code than value-for-money work. Ben Page, Chief Executive of Ipsos MORI told us:

We did a piece of work for Zurich Municipal where we were interviewing senior people from across the sector, both inside local government and in the auditing community. It is widely thought that one of the risks of the scale and the speed of the cuts that we have is that some authorities will simply fall over and there will be service failure.

55. There was more of a consensus that the requirements for grant claims certification were excessive and disproportionately costly relative to the size of the grants and the scale of errors detected. The LGA criticised it as “expensive and unnecessary” and said that in 2008–09 the cost of certification was £18.7 million in relation to grant claims of £45.6 billion. The Audit Commission said this was a significant issue to be resolved; and other witnesses argued that a smaller effort was more appropriate. The ICAEW and others recommended that the government departments providing the grants take on a greater degree of responsibility and that certification be included in the overall audit.
Proportionate and risk based

56. Public sector audit needs to be proportionate and risk based. Its primary purpose is to protect public money but it should also be adaptable for legitimate local needs and provide value in its own right. The code of audit practice needs to reflect these principles. In the early days of local audit committees, a more prescriptive code may be appropriate, but the code should not be enforced in such a way as to stifle local innovation and the benefits of local decision-making.

57. The nature and extent of value for money work prescribed in the code of audit practice is contentious. On balance, we favour the proposal that a council prepare an annual report of its arrangements for delivering value for money, showing what it is trying to achieve and the measures that it is using to improve performance. The auditor should be required to review and provide reasonable assurance on the annual report. This would be a more limited but realistic requirement than requiring auditors to judge whether the council is delivering VfM. Additional VfM work should be an optional, not mandatory, part of the code. Financial resilience must remain a part of the audit code although the scope of the work should be proportionate to risk and clearly related to financial matters. Grant certification work should be brought within the general audit instead of being a disproportionate additional cost. The results of the audit need to be communicated to councillors and public in ways that are more meaningful than currently.
5 Competition in the audit market

Domination by the few

58. The number of firms successfully competing in the public sector audit markets is small. The Audit Commission has 70% of the local government market with only five other firms involved in the remaining 30%. Foundation Trusts use only a small number of audit firms: the Audit Commission Chairman told us that, effectively, this is now down to three including the Audit Commission.92 The NAO uses private audit firms for less than 20% of central government work.

59. The issue of market competition and choice in the public sector cannot be addressed in isolation from the private sector audit market, which is dominated by a small number of large accountancy firms. The House of Lords Economic Affairs Committee recently reported that the dominance of the “Big Four” has limited competition and choice and that attempts to introduce greater competition had failed.93 It recommended that the Government should work to encourage the development of a competitor.94 The Financial Reporting Council is keen to see the Audit Commission audit practice emerge as a fifth large practice, competing in both the public and private sectors.

60. The Government says it wants to see a competitive market develop for local government audit providing choice and lower audit fees. Some of our witnesses were concerned that a similar model of the dominance by a few large audit firms would emerge in the public audit sector, with limited choice and competition. The experience of the Foundation Trusts is not encouraging: only six companies provide audit services, all of which did so through the Audit Commission prior to 2004.95 Witnesses also questioned how the market would be managed to encourage new entrants in the absence of a central procurement body. During the lifetime of the Audit Commission, the number of private firms undertaking local public audit has fallen from 13 in 1983 to five today.96

61. Unless the Government can crack the problem of the very limited competition in the audit market in the UK, it will be open to the accusation that the abolition of the Audit Commission is not a measure to save public money but merely a mechanism to transfer public money into private hands. For local auditor appointment to work, the local government audit market must be opened up to wider competition that provides local authorities with a genuine choice of audit firms. This will require active management and learning from developments in the private sector, such as the outcome of the OFT’s current review. DCLG should work with other appropriate bodies, including DBIS, Competition Commission, FRC, the LGA and professional

92 Q 209
93 House of Lords Select Committee on Economic Affairs (2011), Auditors: Market concentration and their role, HL Paper 119-I, para 33
94 House of Lords Select Committee on Economic Affairs (2011), Auditors: Market concentration and their role, HL Paper 119-I, para 53
95 NLGN Show me the money—accounting for localism, April 2011, p 35
96 Audit Commission, The Future of local audit: issues for consideration, September 2010, p 19
accountancy bodies to deliver a more open and competitive local government audit market.

Audit Commission audit practice

62. The Audit Commission audit practice is the fifth largest audit practice in UK. It is a respected, professional body, as acknowledged by DCLG and others, which has helped to raise standards in local government public audit.97

63. The DCLG is now developing plans to establish the Audit Commission audit practice as a separate entity from Audit Commission, possibly as a mutual, that will compete for local government audit work in future. The proposals are not part of the DCLG consultation. Financial consultants FTI were appointed on 18 April 2011 at a fee of £100,000 “to provide advice on the most cost-effective options for disbanding the Audit Commission” and transferring its in-house audit practice into the private sector.98 It was unhelpful that the Minister did not inform the Committee during oral evidence of the imminent appointment of advisers.99 At that stage the appointment process was well advanced, having started in February.100

64. The Audit Commission audit practice has proved its ability to compete against private audit firms and now audits 52 foundation trusts, comprising 38% of the FT audit market. Gareth Davies, Managing Director of the Audit Commission audit practice, was keen to emphasise to us the positive approach that the practice is taking towards securing a successful future as an all-employee-owned (mutual) business.101 In contrast, Prospect was pessimistic102 about the capacity of a reformed and floated-off audit practice to survive in a competitive environment:

The idea of pulling an organisation like the Audit Commission into that competitive world within the lifetime of this Parliament, let alone in the next 12 to 18 months, is fanciful. I do not believe it has the skills, nor could it attract them.103

The Government made three appointments to the Board of the Audit Commission in November 2010 which it said would “bring significant private sector expertise that will be crucial in steering the organisation as it addresses new challenges”.104

65. We do, however, note Prospect’s concern that staff may be lost to the profession entirely105 if arrangements are not handled properly and speedily, although they told us that the level of staff turnover had not changed significantly.106 The practice may find

97 Ev 228
98 http://www.communities.gov.uk/newsstories/corporate/1889668
99 Qq 568–577
100 HC Deb, 17 May 2011, col 145W
101 Ev 169
102 Qq 287–293
103 Q 290
104 DCLG press notice, The Audit Commission—appointment of new commissioners, 10 November 2010
105 Qq 284–285
106 Q 282
conditions tougher in future without its core workload of guaranteed local government audit work. It is almost inevitable—and desirable, in terms of promoting choice and competition—that its market share will reduce from 70% of the local government audit market.

66. It is vital that the Audit Commission audit practice’s skills and expertise are not lost and that it remain a significant player in local government audit market, in order to provide fee competition and choice. Our favoured outcome is the establishment of a stand-alone company, preferably a mutual. If this proves to be unviable, merger with another audit firm outside the Big Four would be our second preference. Failing both of these, the audit practice should be broken up so that capability is spread to a number of other smaller firms. It would be entirely unacceptable for the practice to be bought by one of the existing Big Four as this would further reduce the already-limited choice and competition. DCLG must also carefully consider the transitional arrangements and ensure that the necessary assistance and stability is provided to assist the audit practice through this period, particularly if the practice is established as a mutual.

Audit fees

67. Lower audit fees are, according to the Government’s consultation document, one of the four key design principles of the Government proposals.107 The minister told us that, with local appointment and without the 20% overhead charge added by the Audit Commission, he was confident that the overall cost of audit fees would come down. By contrast, the Audit Commission pointed out the savings that it had been able to deliver as a result of centralised purchasing of audit services over a long period. The NLGN report, drawing on international experience, found limited evidence on which to predict how fees will change; it found both positive and negative examples of decentralisation of audit and fees. Its UK research found opinion divided over whether fees would rise or fall.108 We heard concern that fees may rise, both in general and in particular for small or remote councils. Auditors Grant Thornton expected that fees would fall in areas such as London but rise in more remote areas such as Cornwall and Cumbria.109

68. The proposals for local government contrast with the situation in central government, where the NAO is reducing the percentage of work that it contracts out to private audit firms:

   Our percentage is low, because we use the private sector to supplement what we do. For completeness of disclosure, it’s probably becoming even a bit less [than 20%], because as we work more efficiently and use our resources better, we find it cheaper to work our in-house resources.110

69. Developing a fully competitive market will be an important element in achieving lower overall audit fees—a key design principle of the Government’s proposals. All

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107 DCLG consultation document, para 1.17
108 NLGN, Show me the money—accounting for localism, April 2011, Chapter 3.
109 Ev w49
110 Q 514
local authorities should be required to publish annually their audit fees, showing separately the cost of the mandatory (code) audit and any additional audit or consultancy work. The figures should be published in a consistent way that allows comparison and analysis.

70. It has been suggested that, without the indemnity provided by the Audit Commission, private audit firms will have to purchase their own indemnity to cover costs that may arise from PIRs or other litigation and that audit fees may rise as a result. This, however, seems unlikely to be significant. The cost of undertaking the PIR has always been charged to the audited body. The Audit Commission indemnifies the private firms with whom it contracts against costs arising out of their statutory audit functions. The indemnity does not protect against negligence. The frequency of litigation appears to be low. Over the past five years, only one call on this indemnity has arisen and the Audit Commission has faced only three cases of litigation. Moreover, audit firms are accustomed to working in the private sector, which is more litigious than local government and where the amounts of money at issue are often very high. In the case of Westminster Council, had the Audit Commission lost its appeal to the House of Lords, it stood to lose £12million—a substantial sum but not enormous by private sector standards.

111 Q 26
112 Ev 171
113 Follow the money, p 506
6 Inspection—improving services

Development of inspection

71. Improving service standards and efficiency are permanent challenges for the public sector. To these ends, the 1997 Labour Government developed a regime whereby it set targets, provided funding and employed inspection services to report and to drive progress. For local government, the principal inspection role was undertaken by the Audit Commission.

72. Whereas the need for audit is long established, the idea of intensive inspection as a means to drive improvement in local government services, value for money and governance is relatively new. The 1997 Labour Government replaced the compulsory competitive tendering requirements with a duty to provide best value—a combination of quality and cost. The Best Value Inspection Service was set up, under the Audit Commission, to inspect local services following best value reviews, and to publish reports with scores for service quality and prospects for improvement. Yet only a year or so into its task the Commission realised that the best value system was excessively bureaucratic and unsustainable, for both the Audit Commission and local government. The Audit Commission proposed comprehensive performance assessment—an assessment of the council as a whole, including corporate capacity, service standards and performance management arrangements—and subsequently undertook CPA of all local authorities (twice) between 2002 and 2008. In 2009 the Audit Commission replaced CPA with comprehensive area assessment, which sought to encourage the council and its various partners to work together more effectively for the benefit of the area. Although CAA took account of a wider set of players than CPA, the Audit Commission’s responsibility was restricted to local government, and it was still, in effect, the local authorities that were judged.

73. One of the first actions of the present Secretary of State was to instruct the Audit Commission to cease work on CAA. The Government has no plans to replace CAA with any other form of centrally-imposed inspection. Inspection will remain for services to vulnerable people—but Audit Commission is not directly responsible for those.

A driver of improvement?

74. The effectiveness of inspection—particularly CPA and latterly CAA—has not been easy to ascertain. The view of Professor Martin was that CPA had led to improvements, particularly in its early stages, getting councils to take tough decisions. The Audit Commission noted the “shock impact of CPA” and cited research by Cardiff University (by Professor Martin) showing improved performance by councils following CPA. The Chairman of the Audit Commission said that if its work improved local government

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114 Follow the money, p 473, 2008
115 Q 2
116 Ev 165 and Q 253
117 Ev 128
Audit and inspection of local authorities

efficiency by just 1% that would represent £2bn of savings. Ipsos MORI, which undertook much of the public opinion research associated with CPA, told us that inspection was popular with the public, although the public’s interest was relatively superficial and the “excellent” CPA ratings awards to some councils were at odds with the public’s view. Ipsos MORI provided data on the views of local authority chief executives: the majority agreed that CPA had had a significant impact but a majority also stated that the burden of CPA outweighed its benefits. APSE concluded that the Audit Commission had achieved improvements “against the priorities that were set by Government”. There was a natural cycle to these systems and “an inspection service should work itself out of a job”. The Women’s Resource Centre said that CPA had forced local authorities to pay greater attention to equalities and women’s rights and that these were now being downplayed.

75. The Local Government Association criticised the “excessive burden” of inspection, estimated by the NAO to cost local and central government combined some £2bn per annum. Councillors Light and Shortland, representing the Local Government Association, acknowledged that CPA—with the power of the Audit Commission behind it—had had impact and had obliged their councils to make changes. However, they cited cases which, in their views, the Audit Commission’s recommendations were inappropriate for local circumstances and the changes proved to be for the worse. The LGA strongly supported the abolition of CAA, which it believed had failed to address its criticisms of CPA. Individual councils were also critical, including Essex County Council, whose chief executive is a former Audit Commission senior manager:

While being responsible for just 25% of public expenditure, local government has been subject to over 80% of centrally administered targets. In addition to this, soft rules through which the regulation framework is given effect—codes of practice, guidance, key lines of enquiry, recommendations, advice notes—are the vehicle for scope creep and they colonise and crowd out the space for local discretion. It also creates an over-bureaucratic system that undermines the fostering of local accountability. The attempt to capture best practice through this route is deeply flawed and acts as a contra-indicator to innovation.

76. Peter Holland, President of the Chief Fire Officers Association, said that although CPA had made a significant positive impact in its initial stages, latterly it had “generated its own intrusion”. The District Council Network argued that CAA focused on upper tier authorities and was of no value to district councils. Other witnesses, such as the TaxPayers’ Alliance and Age UK, said that CPA was too bureaucratic and process-driven; the TaxPayers’ Alliance doubted that sustainable change came as a result. Professor John Seddon, possibly the most outspoken critic of the “command and control” system in general and the Audit Commission in particular, pointed to Portsmouth Council, whose

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118 Ev 154
119 Qq 335 and 337
120 Ev 140. This figure was reported to the Lyons Commission. It does not relate purely to the activities of the Audit Commission.
121 Q 57
122 Ev w12
123 Q 58
housing service had been downgraded by the Audit Commission for failing to undertake benchmarking, despite providing an efficient and popular service. 124 He said that it had long been known in the private sector that you cannot “inspect quality in” and lampooned inspection as “having your face to the inspector and your backside to the customer.”125

77. The majority of our witnesses would probably concur with the view that CPA had impact, particularly in its early stages, but that the impacts were not always locally appropriate and that the costs grew to outweigh the benefits. Performance improved but so did service costs and the overall impact on efficiency was unclear.126 Many strong views have been expressed on these issues, but there has been no formal official investigation of the efficacy of the recent performance management regimes. The NAO has not undertaken any such study.127 Some other areas of public service have done so. For example, child protection services have undergone several reviews, most recently the Munro Review, which recommended a reduction in central prescription and control. It concluded that government should:

remove constraints to local innovation and professional judgment that are created by prescribing or endorsing particular approaches, for example, nationally designed assessment forms, national performance indicators associated with assessment or nationally prescribed approaches to IT systems.128

78. The “command and control” system has an appealing logic: ministers set objectives and targets, local government devises the delivery methods, and an inspection service reports and drives improvement. Yet this has proved to be highly controversial and its benefits uncertain. There has not been a proper examination of issues relating to performance management, inspection and how to drive improvement in local government. A rigorous, dispassionate review of public sector performance management regimes, including targets, indicators, inspection methods and their alternatives, is long overdue.

Sector-led performance management

79. Despite the failings of best value, CPA and CAA, there was a concern amongst some witnesses, such as Professor Martin, that without some form of external inspection, some councils would lack impetus to improve. In his view, it was the wrong time to withdraw inspection, although he also suggested that inspection was more appropriate in a time of central government “largesse” than cuts.129

124 Q 335 and Ev w44
125 Q 373 and John Seddon Systems thinking in the public sector, 2008
126 The 2005 report by Martin and Bovaird found clear improvements in standards. It did not evaluate changes in efficiency. (Steve Martin and Tony Bovaird, Meta-evaluation of the Local Government Modernisation Agenda: Progress Report on Service Improvement in Local Government, ODPM, March 2005) A more recent but smaller study (based on five indicators) concluded that, though CPA may have led to improved services, it did not improve efficiency. (Ben Lockwood and Francesco Porcelli, Incentive Schemes for Local Government: Theory and Evidence from Comprehensive Performance Assessment in England, University of Warwick, 26 April 2011)
127 Qq 470–472 and 508–509
128 DfE, Professor Eileen Munro, The Munro Review of Child Protection: Final Report, Cm 8062, May 2011, p 45
129 Qq 36–37
80. The Local Government Association was firmly against further external inspection, centrally-imposed targets and indicators. In its view, the financial cuts and public expectations were powerful drivers for improvement and efficiency. It also claimed—with some support—that local government was now better run and more deserving of trust and responsibility than ten years ago.131 This suggests that although the centrally imposed regimes of the last government may have proved their value in setting local government on the right track, the time has indeed now arrived when they had served their purpose. However, it might also suggest that there will always remain a tension between driving improvement from the centre and securing improvement through delegation and trust. This tension will not disappear, whatever approach the government of the day favours.

81. The Local Government Association has proposed its own regime of sector-led performance management, with peer reviews, a data hub (to provide comparative data on costs and outcomes) and best practice guidance.132 These may prove to be the most practicable way forward although there remains a risk that some local authorities may opt out of such voluntary arrangements. The Government has not formally endorsed these proposals although the Minister suggested that “peer inspection and peer review have an important part to play” particularly in sounding the alarm on failing councils.133

82. We accept that the era of centrally-imposed targets and routine external inspection of local government is over. Innovation and local solutions are more important than assessment. In the current climate the severe budget reductions faced by local government will drive change in most local authorities.

83. We anticipate an extended role for scrutiny and internal audit by local authorities.134 As we note in our report on localism, the local authority scrutiny function is an under-appreciated tool for local accountability. Local authorities themselves, and others, viewed effective scrutiny by non-executive councillors as a necessary complement to greater local discretion and less central oversight. The Centre for Public Scrutiny argued in evidence to that inquiry that as an accountability mechanism, the scrutiny function is credible, legitimate and proven to have genuine impact on services. Councillors acting in this official capacity arguably stand a much better chance than an informed minority of public ‘armchair auditors’ of making effective use of spending data. Furthermore, scrutiny is a way of addressing performance that is more public-facing than peer review, and several organisations pointed out that its scope could be broadened to involve other stakeholders alongside elected members.135 We recommended in that report that the Government address the contribution to accountability that can be made by robust—and if necessary enhanced—local authority scrutiny functions.136

130 Q 164
131 Q 83
132 LGA: Freedom to lead, 2010
133 Qq 588 and 593
134 NLGN, Show me the money—accounting for localism, April 2011, p 58
135 Localism, Third Report of Session 2010-12, HC 547, 7 June 2011, para 73
136 Ibid, para 74
84. We welcome the LGA’s proposals for sector-led performance management. However, they suffer from the limitation that they are optional and there is no formal mechanism to identify poorly performing local authorities, who may choose not to participate. It remains to be seen how vigorously and effectively they are implemented. The Government should clarify its position on sector-led arrangements and whether it intends to provide any further policy or legislative framework. We return to the issue of serious service failure below.

Performance indicators and public reporting

85. In addition to ending CAA, the Government has told local authorities that it no longer intends to collect national indicators. Indeed, DCLG is compiling a single data list with the intention of limiting the data demands made of local government by Whitehall. The Government is emphasising that local government should place more information in the public domain but it will be for local government to decide which data and in what format:

> A key part of the change will be putting information into the public domain in an accessible and readily comparable format so people have access to the information they need to judge the performance of their local service providers, and hold them to account. National government will still have a role to play in aggregating data of national importance, or to allow accountability to Parliament, but it is for local authorities to provide local residents with the data they need.

86. Some of our witnesses were concerned that, without a standardised and mandatory system, the public would not be able to access comprehensive data, place them in context or compare them with other councils. APSE suggested a ‘dashboard’ of five national performance indicators (PIs). However, APSE’s member survey showed concerns that simplification of performance information could mislead the public and would be misused by the media. David Walker asked why any national indicators were required under a regime of localism in which local government was trusted.

87. The LGA is proposing its own system of comparative data with a focus on outcomes. The LGA believes this would be more useful than the previous system. It is unclear how this would be better than the system overseen by the Audit Commission, which went to great lengths to ensure that data were robust and to enable analysis on a fair basis—for example by comparison against authorities of a similar type or with similar socio-economic characteristics. Furthermore, the wider problems associated with performance data—including gaming and perverse incentives—would still exist.

88. It now seems inevitable that there will be a lack of comprehensive, consistent data on which authorities can be compared. There are calls to reinstate some limited form of national indicators to allow comparison between councils. This may seem attractive but

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137 A set of 200 national indicators was introduced in 2009, replacing a more extensive set of the best value performance indicators.
138 Ev 231
139 Ev 187
140 Q 37
141 Q 255
Audit and inspection of local authorities

it is unclear how it would avoid the problems and anomalies of the previous indicator sets. We consider that the emphasis, at least for now, should be on comprehensive local reporting against local objectives with maximum transparency. Nevertheless the need for a broader perspective will remain. We recommend that the need for and adequacy of comparative performance data be reviewed two years from now, once the new arrangements have bedded in.

Variation, failure and intervention

89. It is inevitable that, under a more devolved system, services will vary in their nature and standard. Councillor Fleming, representing the District Councils Network, argued that the mentality that all councils had to be the same was harmful; under localism, more variation would occur, which he welcomed. Variations in service standards will be generally acceptable if they are to the benefit of local people; if people perceive that they are receiving a lower standard of service than those in other localities, they will be apt to complain. It is unclear to what extent ministers will accept variety in service standards. DCLG Permanent Secretary Sir Bob Kerslake has commented:

One of the consequences of localism is that if you transfer responsibility to a local level then the outcomes will differ. The question is about where we will tolerate differences and how much they will be tolerated.

90. As we pointed out in our recent report on localism, Ministers will need to rein in their interventionist instincts if the Government’s localism agenda is to be credible. The litmus test of localism will be the Government’s reaction to local decisions with which it disagrees: continued Ministerial intervention in matters of service standards such as the frequency of local bin collections is not compatible with a genuinely localist agenda. We recommended in that report a strengthening of the mechanisms for local democratic accountability, in particular the local authority scrutiny function, in order to forestall campaigning groups’ reliance on national government to enforce acceptable standards of service.

91. At some point, however, local variety becomes failure. The Government says it is “not proposing great changes” to its powers of intervention; but, without the Audit Commission or any other body charged with examining and reporting on local authority services (other than those for children and vulnerable adults), it is not clear how services at risk of failure would be identified, nor how ministers would intervene if it appeared necessary. The Minister suggested that responsibility for raising the alarm would be spread more widely and peer review members would write “to the auditor, the Secretary of State

142 Q 146
143 Public Servant, April 2011, p 5. The article states that “DCLG Permanent Secretary Sir Bob Kerslake said that ministers would be willing to overlook local variations in the quality of some local services, but it would be up to local government leaders to ensure that there is no reduction in the standard of core services such as health and education.”
144 Localism, Third Report of Session 2010-12, HC 547, 7 June 2011, para 57
145 Ibid, paras 72–76
146 Q 593
or whoever is required.” As we note above, however, peer review will be essentially voluntary and underperforming local authorities may opt out of it. The Audit Commission Chairman raised his concerns that the arrangements for identifying failure and for intervening would be weaker.

92. Some argue—as we discussed in our recent report on Localism—that the risk of failure must be accepted as inherent in decentralisation, and that central government should intervene only when there is a clear national interest requiring action. Others, however—including leading figures in the sector itself—accept that central government needs to continue to act as a failsafe, protecting localities from the most severe consequences of failure. We recommended in that report that the Government make clear the grounds on which intervention in local services would be deemed necessary. In the context of this current report, it is clear that not only the grounds, but also the mechanisms, for such intervention need to be clarified.

93. It would be idle to pretend that intervention by central government in the conduct of local authorities is never going to be necessary. It should therefore be well-regulated and based on clear and transparently-applied criteria—preferably statutory. Some local authorities will inevitably perform better than others. In some cases, council services will fall below acceptable standards, or a council itself may fail. We reiterate the recommendation in our report on Localism that the Government make clear the grounds on which intervention in local services will be deemed necessary. We further recommend that, in cases of serious service or corporate failure, the Government set out not only the grounds on which intervention might take place, but also the mechanisms that would trigger intervention and how it would be undertaken. It should do so in close consultation with the local government sector, including the Local Government Association, but mindful of the fact that the LGA is a voluntary membership body which may not itself be capable of identifying or dealing with all cases of serious service failure.

147 Q 592
148 Qq 258–260
149 Localism, Third Report of Session 2010-12, HC 547, 7 June 2011, para 68
150 Ibid, para 70
7 National Value for Money studies

The studies programme

94. The Audit Commission has a statutory duty to carry out studies into the impact of central government legislation, regulation and direction on the ability of local authorities to deliver value for money.\textsuperscript{151} In 2009–10 the Audit Commission spent about £5m on some 24 national studies—an average cost of approximately £200,000. It has since scaled back its programme to around £1m for 2010–11. The studies have covered a wide range of topics in many sectors as well as cross-sectoral studies. The topics include those that would be readily recognised as value for money, such as fraud and pensions, and those that, at least initially, might not be, such as migration, domestic abuse and road safety. A small number of studies have been undertaken jointly with the NAO.\textsuperscript{152}

Their value

95. The Audit Commission’s view is that “our national studies define value for money and how it can be improved”\textsuperscript{153} providing valuable, in depth and independent research. The reports are not primarily designed to pass judgements retrospectively but to look for future improvement. The Commission’s view is that, particularly at a time of public sector spending cuts, the loss of its expertise on value for money is “counter-intuitive” and that other organisations will not be able to replicate it.\textsuperscript{154} Its Chairman cited \textit{Are we there yet?} and \textit{Tired of hanging around} as recent examples demonstrating that the Audit Commission was prepared to criticise central government as well as local government.\textsuperscript{155}

96. In its written evidence to our inquiry the Department for Communities and Local Government noted the Audit Commission’s research programme but made no comment on its quality or usefulness. In oral evidence, the Minister criticised the studies for being overly prescriptive in their definitions of what constituted value for money.\textsuperscript{156}

97. The Local Government Association’s observations on the national value for money studies were critical. In particular, it said that, despite consulting the Local Government Association, the Audit Commission’s programme had not sufficiently reflected the needs of the sector and that “the Commission’s apparent desire to grab the headlines” had distorted the overall message on occasions.\textsuperscript{157}

98. Individual witnesses and organisations pointed to specific reports that they felt had been of value in their sector. APSE, for example, praised the report \textit{Positively charged} for

\textsuperscript{151} Ev 161
\textsuperscript{152} For example, \textit{A review of collaborative procurement across the public sector}, 21 May 2010.
\textsuperscript{153} Ev 167
\textsuperscript{154} Ev 166
\textsuperscript{155} Q 205
\textsuperscript{156} Q 597
\textsuperscript{157} Ev 139
highlighting the lack of corporate charging strategies in a high proportion of councils.\textsuperscript{158} Age UK said how valuable \textit{Don't stop me now} and \textit{Under pressure} had been. Age UK had produced similar reports itself, but was concerned about accessibility of the information.\textsuperscript{159} A further constraint—for several of our witnesses—was funding to undertake such studies.\textsuperscript{160}

99. The TaxPayers’ Alliance supported the approach of diverse reports by non-governmental organisations; its CEO did not feel the Audit Commission reports had the same impact or themselves provided value for money. Professor Seddon argued that value for money was a beguiling concept—hard to disagree with yet difficult to define operationally. He was critical of the Audit Commission for prescribing solutions which, though plausible, had sometimes turned out to be wrong and excluded other approaches which did not fit with their preconceptions. He pointed to the 2005 report on housing benefit\textsuperscript{161} which according to APSE, the Audit Commission revised in 2008.\textsuperscript{162}

\textbf{NAO to take on the role}

100. The Government has proposed that responsibility for VfM studies should pass to the NAO, which would be able to undertake reports using its existing powers, once confirmed by the Treasury.\textsuperscript{163} The Minister told us that the Government also expects to see research undertaken by a wide range of organisations, and such research could be more expert and powerful. He cited work by Shelter as having had impact. He welcomed a plurality of views.\textsuperscript{164}

101. The NAO has an existing annual programme of around 60 VfM studies and a budget of around £20m.\textsuperscript{165} The C&AG saw no problem with the NAO taking on this additional role although he said that he would need to assess the need for additional resources.\textsuperscript{166} The C&AG was confident that the NAO already had expertise in the local government sector and could strengthen its capacity if required.

102. The Local Government Association would like to have greater involvement in future value for money studies, and for the programme to be smaller and of high quality. It suggests that, instead of simply passing to the NAO, the studies should be linked to the productivity programme of the Local Government Group. They could be funded by top slicing of revenue support grant or savings from abolition of the Audit Commission.\textsuperscript{167}
103. Over the years the Audit Commission has produced some of useful national value for money studies, but the programme has become excessive and not sufficiently linked to the needs of the sector. Not all the studies have proved helpful or, at £5 million a year, themselves provided value for money. We believe that a smaller, more selective programme would be better. It would be wrong for one part of public expenditure—local government—to be excluded from VfM assessment and the National Audit Office should ensure that local government services and expenditure are given due weight in its studies programme. Provided that the National Audit Office has, or acquires, the necessary expertise in local government matters, there may be some advantages to having a more unified approach to reporting on public expenditure across both local and central government. Additionally, we welcome reports by a diverse range of organisations, including those from outside government, and recommend that the National Audit Office, Local Government Association and Department for Communities and Local Government encourage collaborative working and seek to ensure information is made available to all serious researchers. The NAO and LGA should lead on devising a coherent programme that adequately covers priority topics and avoids undue overlap.

104. The proposal for the National Audit Office to take on this role is workable and, as we note above, may have some advantages over the existing arrangements. However, the way in which the announcement was made did not show a proper respect for the constitutional position whereby the Comptroller and Auditor General, the head of the NAO, is an officer of Parliament, and the funding for NAO work is granted directly by Parliament, through the Public Accounts Commission, rather than by Government. It is not for the Secretary of State—any Secretary of State—to transfer work to the National Audit Office without proper consultation with Parliament first.

105. The transfer of responsibility for national value for money studies to the NAO involves a transfer of costs from DCLG to Parliament. We recommend that the Comptroller and Auditor General make an assessment of what it will cost to ensure that the NAO is able to carry out an adequate programme of VfM studies of local government expenditure; that he discuss his requirement for the necessary resources with the Public Accounts Commission; and that DCLG make a clear transfer of the necessary resources to the Public Accounts Commission from the savings from the abolition of the Audit Commission.
8 Conclusion

106. The Government has set the audit and inspection of local government on a very different course. In inspection—with a fair degree of support—it has put a stop to the ‘command and control’ regime of the past decade; in audit—with less clear cut support—it has proposed a system that challenges some of the principles of public audit that have been established over many decades—most notably that public bodies should not appoint their own auditors.

107. These changes are consistent with the Government’s wider moves to localism and greater financial independence for local government, placing greater responsibility for financial and performance management in the hands of local government and communities. They have been largely welcomed by the LGA, representing the local government sector as a whole. The changes are also consistent with the reduced inspection regimes being introduced in other government departments, such as health and education.168

108. The changes bring opportunities and risks. The opportunities are for local government to develop audit and performance management procedures that are better attuned to local needs, allowing good local government to innovate and deliver improved services that meet local priorities, thereby giving better value for money. The risks are that the audit market will not be sufficiently competitive, that some councils will struggle to establish robust independent audit committees and that accountability for public money will be reduced. There is the further risk that corporate or service failures will arise and that some councils will lack a serious incentive to improve—although failures have, of course, occurred under previous regimes.

109. In implementing these changes, the Government must be mindful of the fact that devolving power to local government and communities does not absolve it of the responsibility to construct a system which continues to provide accountability for public money and which results in better value for money. That is so more especially whilst the lion’s share of local government spending remains funded by central government.

110. The legislative framework for public audit, competition within the local government audit market, the future of the Audit Commission audit practice, and clarity over arrangements for intervention in cases of serious corporate failure are all crucial to the success of the proposed system. The abolition of the Audit Commission will leave a substantial hole in the system of audit and inspection in local government and ministers must not assume that freedoms and market forces will automatically fill it. It will require active and careful management, particularly in the period of transition. The Minister did not offer any specific criteria against success would be measured other than Parliamentary scrutiny.169 We intend to keep a watching brief on this issue and to hold ministers to

168 Ev 231
169 Q 604–606
account for the success—or otherwise—of these important changes to audit and inspection in local government.
Conclusions and recommendations

Abolition and fragmentation

1. We accept that sometimes policy-led decisions have to be made quickly and without lengthy prior evaluation and consultation. The decision appears to have been taken without a clear evidence base. There is potentially an opportunity for a valuable reassessment of the arrangements for public audit. The Government has also effectively ruled out consideration of the potentially useful option of retaining a residual function for the Audit Commission, which may have presented an opportunity to prevent the fragmentation of functions. (Paragraph 17)

2. We are now some way down the road of the abolition of the Commission, and, as we report below, further delay in finalising arrangements could jeopardise the chances of a smooth transfer of its audit practice into the private sector. In the short term, therefore, the Government should concentrate on successful implementation of the changes it proposes. Nevertheless we are critical of the manner in which this major policy change has been handled, and the missed opportunities which have resulted. Once new arrangements are in place, we recommend that the Government instigate a wide-ranging review of public sector audit and how it fits into the wider context of accountability for the expenditure of public money. Such a review should be carried out in close consultation with Parliament, in particular through the relevant select committees. (Paragraph 18)

Savings from abolition of the Audit Commission

3. DCLG should demonstrate its commitment to transparency by reporting and monitoring annually for the next five years on the full savings and costs in respect of: the abolition of the Audit Commission and the tasks transferred to other bodies, and how these compare with costs under the existing system. (Paragraph 24)

Local appointment

4. The Government is proposing a departure from the established practice that public bodies should not appoint their own auditors. The proposals place a great responsibility on the Government to create adequate legal safeguards and assist local government in establishing local audit committees that are, and are seen to be, capable and independent. Advice, training and resources will be required. The National Audit Office, on whose evidence we have placed considerable weight, must also ensure that the system succeeds. (Paragraph 37)

5. The legislation will have to provide clear and uncontestable protections for assuring the independence of audit committees and auditors. We recommend that final responsibility for appointment of the auditor should lie with the full council, following a recommendation of the audit committee. Dismissal of the auditor should also be a decision for full council, following the recommendation of the audit committee. The regulations should provide a ‘double lock’ so that neither body is allowed to dismiss the auditor without the agreement of the other. Full transparency
and public reporting of the workings of the audit committee will be essential. (Paragraph 38)

6. Audit committees must be chaired by independent persons of proven competence, and should have a majority of independent members. These requirements (including the avoidance of conflicts of interests for independent members) should be defined in law. Chairing of audit committees will be a significant responsibility and should be remunerated, and allowances should be payable to other independent members. The law should require full transparency for audit committee proceedings. (Paragraph 39)

Public interest reporting and objections to accounts

7. The Government has proposed that arrangements for public interest reporting continue without additional safeguards. However, the abolition of the Audit Commission as overseer and guarantor of public interest reporting represents a fundamental change to this aspect of local auditor appointment. Therefore changes are required to the Government’s proposals to safeguard public interest reporting, as indicated by several witnesses. These should include an explicit requirement in the duties specified for the audit committee in the primary legislation to support the auditor in any reasonable recommendation for a public interest report; and the professional oversight body (or bodies) responsible for accrediting auditors for local government audit work, should be specifically required to consider the competency of firms to undertake this role and to monitor the standard of public interest reporting undertaken. In addition, the oversight body should be given powers to appoint a separate organisation to undertake the investigation and report, where necessary. (Paragraph 44)

Right of objection

8. The statutory right of the public to object to accounts should be replaced by more proportionate arrangements. We recommend that, for larger bodies, objections be investigated by the s151 officer, who would inform the local audit committee and auditor of the objection and the investigation. The auditor would be free to decide whether it merited further attention and, if so, by whom. The public’s rights to inspect accounts and to ask questions of the council would remain. (Paragraph 46)

Responsibility for the audit code, standards and consistency

9. We agree that the NAO is best-placed of the remaining bodies concerned with public audit to prepare the code of audit practice. It should do so in conjunction with the LGA, professional accountancy bodies and other appropriate stakeholders, who should be made statutory consultees. Ensuring consistency in audit is a related task, and key matter, responsibility for which has not been specified. The Government must clarify how consistency in audit is to be achieved before the new system is introduced. (Paragraph 49)

10. In preparing the code of audit practice, the NAO will—subject to the approval of the Public Accounts Commission—incur additional costs, and may have to build
capacity to fulfil these functions. We invite the Public Accounts Commission to monitor costs and seek to ensure that they do not exceed those previously incurred by the Audit Commission. (Paragraph 50)

Scope of audit: key elements

11. Public sector audit needs to be proportionate and risk based. Its primary purpose is to protect public money but it should also be adaptable for legitimate local needs and provide value in its own right. The code of audit practice needs to reflect these principles. In the early days of local audit committees, a more prescriptive code may be appropriate, but the code should not be enforced in such a way as to stifle local innovation and the benefits of local decision-making. (Paragraph 56)

12. The nature and extent of value for money work prescribed in the code of audit practice is contentious. On balance, we favour the proposal that a council prepare an annual report of its arrangements for delivering value for money, showing what it is trying to achieve and the measures that it is using to improve performance. The auditor should be required to review and provide reasonable assurance on the annual report. This would be a more limited but realistic requirement than requiring auditors to judge whether the council is delivering VfM. Additional VfM work should be an optional, not mandatory, part of the code. Financial resilience must remain a part of the audit code although the scope of the work should be proportionate to risk and clearly related to financial matters. Grant certification work should be brought within the general audit instead of being a disproportionate additional cost. The results of the audit need to be communicated to councillors and public in ways that are more meaningful than currently. (Paragraph 57)

Domination by the few

13. Unless the Government can crack the problem of the very limited competition in the audit market in the UK, it will be open to the accusation that the abolition of the Audit Commission is not a measure to save public money but merely a mechanism to transfer public money into private hands. For local auditor appointment to work, the local government audit market must be opened up to wider competition that provides local authorities with a genuine choice of audit firms. This will require active management and learning from developments in the private sector, such as the outcome of the OFT’s current review. DCLG should work with other appropriate bodies, including DBIS, Competition Commission, FRC, the LGA and professional accountancy bodies to deliver a more open and competitive local government audit market. (Paragraph 61)

Audit Commission: audit practice

14. It is vital that the Audit Commission audit practice’s skills and expertise are not lost and that it remain a significant player in local government audit market, in order to provide fee competition and choice. Our favoured outcome is the establishment of a stand-alone company, preferably a mutual. If this proves to be unviable, merger with another audit firm outside the Big Four would be our second preference. Failing both
of these, the audit practice should be broken up so that capability is spread to a number of other smaller firms. It would be entirely unacceptable for the practice to be bought by one of the existing Big Four as this would further reduce the already-limited choice and competition. DCLG must also carefully consider the transitional arrangements and ensure that the necessary assistance and stability is provided to assist the audit practice through this period, particularly if the practice is established as a mutual. (Paragraph 66)

Audit fees

15. Developing a fully competitive market will be an important element in achieving lower overall audit fees—a key design principle of the Government’s proposals. All local authorities should be required to publish annually their audit fees, showing separately the cost of the mandatory (code) audit and any additional audit or consultancy work. The figures should be published in a consistent way that allows comparison and analysis. (Paragraph 69)

A driver of improvement?

16. The “command and control” system has an appealing logic: ministers set objectives and targets, local government devises the delivery methods, and an inspection service reports and drives improvement. Yet this has proved to be highly controversial and its benefits uncertain. There has not been a proper examination of issues relating to performance management, inspection and how to drive improvement in local government. A rigorous, dispassionate review of public sector performance management regimes, including targets, indicators, inspection methods and their alternatives, is long overdue. (Paragraph 78)

Sector-led performance management

17. We welcome the LGA’s proposals for sector-led performance management. However, they suffer from the limitation that they are optional and there is no formal mechanism to identify poorly performing local authorities, who may choose not to participate. It remains to be seen how vigorously and effectively they are implemented. The Government should clarify its position on sector-led arrangements and whether it intends to provide any further policy or legislative framework. (Paragraph 84)

Performance indicators and public reporting

18. It now seems inevitable that there will be a lack of comprehensive, consistent data on which authorities can be compared. There are calls to reinstate some limited form of national indicators to allow comparison between councils. This may seem attractive but it is unclear how it would avoid the problems and anomalies of the previous indicator sets. We consider that the emphasis, at least for now, should be on comprehensive local reporting against local objectives with maximum transparency. Nevertheless the need for a broader perspective will remain. We recommend that the
need for and adequacy of comparative performance data be reviewed two years from now, once the new arrangements have bedded in. (Paragraph 88)

**Variation, failure and intervention**

19. It would be idle to pretend that intervention by central government in the conduct of local authorities is never going to be necessary. It should therefore be well-regulated and based on clear and transparently-applied criteria—preferably statutory. Some local authorities will inevitably perform better than others. In some cases, council services will fall below acceptable standards, or a council itself may fail. We reiterate the recommendation in our report on Localism that the Government make clear the grounds on which intervention in local services will be deemed necessary. We further recommend that, in cases of serious service or corporate failure, the Government set out not only the grounds on which intervention might take place, but also the mechanisms that would trigger intervention and how it would be undertaken. It should do so in close consultation with the local government sector, including the Local Government Association, but mindful of the fact that the LGA is a voluntary membership body which may not itself be capable of identifying or dealing with all cases of serious service failure. (Paragraph 93)

**NAO to take on the role**

20. Over the years the Audit Commission has produced some of useful national value for money studies, but the programme has become excessive and not sufficiently linked to the needs of the sector. Not all the studies have proved helpful or, at £5 million a year, themselves provided value for money. We believe that a smaller, more selective programme would be better. It would be wrong for one part of public expenditure—local government—to be excluded from VfM assessment and the National Audit Office should ensure that local government services and expenditure are given due weight in its studies programme. Provided that the National Audit Office has, or acquires, the necessary expertise in local government matters, there may be some advantages to having a more unified approach to reporting on public expenditure across both local and central government. Additionally, we welcome reports by a diverse range of organisations, including those from outside government, and recommend that the National Audit Office, Local Government Association and Department for Communities and Local Government encourage collaborative working and seek to ensure information is made available to all serious researchers. The NAO and LGA should lead on devising a coherent programme that adequately covers priority topics and avoids undue overlap. (Paragraph 103)

21. The proposal for the National Audit Office to take on this role is workable and, as we note above, may have some advantages over the existing arrangements. However, the way in which the announcement was made did not show a proper respect for the constitutional position whereby the Comptroller and Auditor General, the head of the NAO, is an officer of Parliament, and the funding for NAO work is granted directly by Parliament, through the Public Accounts Commission, rather than by Government. It is not for the Secretary of State—any Secretary of State—to transfer
work to the National Audit Office without proper consultation with Parliament first. (Paragraph 104)

22. The transfer of responsibility for national value for money studies to the NAO involves a transfer of costs from DCLG to Parliament. We recommend that the Comptroller and Auditor General make an assessment of what it will cost to ensure that the NAO is able to carry out an adequate programme of VfM studies of local government expenditure; that he discuss his requirement for the necessary resources with the Public Accounts Commission; and that DCLG make a clear transfer of the necessary resources to the Public Accounts Commission from the savings from the abolition of the Audit Commission. (Paragraph 105)

Conclusion

23. In implementing these changes, the Government must be mindful of the fact that devolving power to local government and communities does not absolve it of the responsibility to construct a system which continues to provide accountability for public money and which results in better value for money. That is so more especially whilst the lion’s share of local government spending remains funded by central government. (Paragraph 109)
Draft Report (Audit and Inspection of Local Authorities), proposed by the Chair, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 110 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report (ordered to be published on 6 December 2010, 24 January, 7 February, 7 March, 14 March and 21 March 2011).

[Adjourned till Monday 4 July at 4.00 p.m.]
Witnesses

Monday 7 February 2011

David Walker, Contributing Editor, Guardian Public, Professor David Heald, Professor of Accountancy, University of Aberdeen Business School and Professor Steve Martin, Professor of Public Policy and Management and Director of the Centre for Local and Regional Government Research, University of Cardiff

Monday 7 March 2011

Peter Holland, President, Chief Fire Officers Association, Peter Lacey, Audit and Accounts Adviser, National Associations of Local Councils, Councillor Robert Light, Deputy Chairman, LG Group Executive, Local Government Association and Councillor Jill Shortland, Vice Chair, Local Government Association Improvement Board

Councillor Peter Fleming, Leader, Sevenoaks District Council, District Councils Network, Councillor Roger Phillips, Leader, Herefordshire Council, Member of management Committee, County Councils Network, Councillor Sharon Taylor, Leader, Stevenage Borough Council, District Councils Network, Councillor Dave Wilcox, Former Cabinet Member for External Affairs, Derbyshire County Council, Member of management Committee, County Councils Network

Monday 14 March 2011

Ben Page, Chief Executive, Ipsos MORI, Jessica Crowe, Executive Director, Centre for Public Scrutiny and Simon Parker, Director, New Local Government Network

Michael O’Higgins, Chairman and Eugene Sullivan, Chief Executive, Audit Commission

Monday 21 March 2011

Dai Hudd, deputy General Secretary and Chris Round, Audit Commission Branch Chair, Prospect

Belinda Wadsworth, Strategy Adviser, Local and Regional Policy, Age UK, Rebecca Veazey, Policy Officer, Women’s Resource Centre and Matthew Sinclair, Director, The TaxPayers’ Alliance

Paul O’Brien, Chief Executive, Association for Public Service Excellence and Professor John Seddon, Managing Director, Vanguard Consulting
Tuesday 29 March 2011

Nigel R Johnson, Assurance and Advisory Partner, Deloitte, Gervase MacGregor, Head of Advisory Services, BDO LLP and Rakesh Shaunak, Principal, MHA

Vernon Soare, Executive Director, Institute of Chartered Accountants in England and Wales, Gillian Fawcett, Head of Public Sector, Association of Chartered Certified Accountants and Steve Freer, Chief Executive, Chartered Institute of Public Finance and Accountancy

Paul George, Executive Director of the Professional Oversight Board and Director of Auditing, and Dame Barbara Mills, Chair of the Professional Oversight Board, Financial Reporting Council

Monday 4 April 2011

Amyas Morse, Comptroller and Auditor General

Grant Shapps MP, Minister for Housing and Local Government, Department for Communities and Local Government

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Age UK Ev 177
APSE Ev 183
Audit Commission Evs 161, 170
Audit Practice of the Audit Commission Ev 169
BDO LLP Ev 199
Centre for Public Scrutiny Ev 149
Chartered Institute of Public Finance and Accountancy (CIPFA) Ev 213
Chief Fire Officers Association (CFOA) Ev 133
County Councils Network Ev 144
Deloitte LLP Ev 194
Department for Communities and Local Government Evs 228, 233
District Councils’ Network Ev 142
Financial Reporting Council (FRC) Ev 222
Professor David Heald Ev 124
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Professor Steve Martin Ev 127
National Association of Local Councils (NALC) Ev 130
New Local Government Network (NLGN) Ev 146
Prospect Ev 172
Taxpayers Alliance
David Walker
Vanguard Consulting
Women’s Resource Centre

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(published in Volume II on the Committee’s website www.parliament.uk/clgcom)

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Oral evidence

Taken before the Communities and Local Government Committee

on Monday 7 February 2011

Members present:
Mr Clive Betts (Chair)

Heidi Alexander
Bob Blackman
Simon Danczuk
Mike Freer
Stephen Gilbert
George Hollingbery
James Morris
Mark Pawsey

Examination of Witnesses

Witnesses: David Walker, Contributing Editor, Guardian Public, Professor David Heald, Professor of Accountancy, University of Aberdeen Business School, and Professor Steve Martin, Professor of Public Policy and Management and Director of the Centre for Local and Regional Government Research, University of Cardiff, gave evidence.

Q1 Chair: Good afternoon. Welcome to all three of you to the first evidence session of our inquiry into the audit and inspection of local authorities. To begin with, and for the sake of our records, may I ask all of you to introduce yourselves and say who you are?

David Walker: I am David Walker and I am a contributing editor to Guardian Public. For the record, I was until October managing director of communications at the Audit Commission.

Professor Martin: I am Steve Martin, Professor of Public Policy and Management at Cardiff Business School.

Professor Heald: I am David Heald, Professor of Accountancy at the University of Aberdeen Business School.

Q2 Chair: You are all most welcome.

To begin with, I put a very difficult question that I am sure you won’t have anticipated: did the Audit Commission deserve to be abolished?

Professor Heald: In my view, no. There are some fundamental issues about public audit that Parliament has to deal with. I think the abolition of the Audit Commission has thrust those on to the agenda in a way that might not otherwise have happened. There is some evidence that the Audit Commission has lost its stakeholders. If you look at some of the responses from local government, they have not been at all sympathetic to the Audit Commission. That is probably much more to do with the assessment activities than the actual audit activities. It was very interesting that, when the Audit Commission was thoroughly rubbished at the time of the announcement in August, under a freedom of information request I asked CLG what evaluations had been done of the performance of the commission. I was told none. I went to internal review and was sent two documents, which were reviews of the performance of the board, not the Audit Commission. There has been a fundamental failure by Government in terms of the review of the Audit Commission. The other issue is that Parliament has also failed in the context of thinking about public audit. The issue about the status of the National Audit Office has been on the go for two and a half years. The provisions to make it a corporate body fell at the wash-up. It is quite remarkable that when the Government want something done in a hurry, it gets done, but when things are fundamentally important to Parliament and the discharge of public accountability, they do not get done. I keep drawing a contrast with what happened in 1983 when the National Audit Act establishing the National Audit Office was passed. I think that now Parliament almost accidentally has come to a point when those issues cannot be avoided any longer.

David Walker: Absolutely. The case could be made on the basis of evidence. Go back to a decade ago when your colleague in the House of Lords, Lord Sharman of Redlynch, produced a report that implicitly concluded that there was a strong case for rationalising audit in England. What I have tried to say in my evidence is that the way in which the Communities Secretary went about his work was questionable, but he had an absolute right to examine the functioning of a body which, since it was created in 1983, had gone through a number of transformations, not necessarily all for the best. I think there was at the least a very strong case for a review, and possibly that review coming to a conclusion, but that should have been an evidence-led review.

Professor Martin: There is a serious danger of agreement breaking out among your witnesses. I certainly agree with David Heald and to some extent with David Walker. Our evidence, unpopular though it has been sometimes with local government, is that even the assessments of local government, about which perhaps people have most doubt, have been effective in a variety of ways. Therefore, it is quite possible to argue that there were diminishing marginal returns with repeated inspections of local government and that the commission over-reached itself in a number of ways. It is certainly the case that it lost some friends, and the debate in the run-up to the election became a rather tetchy affair in public, although privately I found that senior officials in the commission were much more reflective than it might have seemed from the outside.
Nevertheless, I believe that its abolition leaves quite a big gap. I know much less about audit than my two distinguished colleagues, but in terms of the assessment and inspection of local government, I think that is reflected in the evidence I have already given to you. There are a number of ways in which CPA and then CAA even in its first year had really beneficial effects in terms of the kinds of things for which we have been looking in our research.

Q3 Bob Blackman: Obviously our questions we will touch on audits, inspections and so on but, looking specifically at the Audit Commission, one of the issues of concern is the costs and activities that the commission got up to. Mr Walker, I think that during the year 2009–10, when you were there, you paid £2.3 million to employ 48 staff in your department. That sounds to me like an awful lot of money given what we are talking about generally speaking in the professional auditing area.

David Walker: I will make this point once. I think that, as a Select Committee, you have better things to do with your time than re-warm answers to a set of parliamentary questions that your colleagues have been asking since at least autumn 2009. The answer given on all occasions was: “operational matters for the Audit Commission”. If the Government of the day did not like what the Audit Commission was doing, they had various remedies, including changing the commissioners, which would have been a rational way, and changing the chairman of the commission, which is a normal practice with arm’s length bodies. Other than that, the commission was subject to a series of questions of that rather aggressive kind.

To answer your question directly, a large organisation needs to have a communications function, particularly one that endeavours to communicate with the general public about difficult issues. The year that you are talking about was one in which we were trying to render to the public—you may not like CAA but it was an existing programme—a detailed set of assessments of how the local service economy in the local areas of England was functioning. We can debate whether that was insufficient or too much, but the case for spending on public relations and communications is surely unassailable.

Q4 Bob Blackman: So do you think that is a good use of public money?

David Walker: I think it is a necessary one. Parliament enjoined the Audit Commission to do various things, including communicate with local authorities and the public. I fail to see how it could have done that without the expenditure of a reasonable sum of money. If you look at the evidence that the Department for Communities has itself collected to compare the spending of the Audit Commission on communications with that of other arm’s length bodies within its so-called family, you will find that the commission’s spending is reputable.

Q5 Bob Blackman: But do you personally feel that that was a reasonable use of public money for that purpose?

David Walker: I repeat that it is a necessary use of public money given the statutory obligations placed on this body. We had no choice in exercising of the will of the institution of which you are a Member to carry out communications functions to try to reach out to local authorities and elected members. We had a special programme to try to tell councillors what we were doing and about things of interest in their wards and areas, and to tell the public what we were doing. We had no choice but to carry out that obligation.

Q6 Bob Blackman: There are a couple of other areas. I think there was the Eurorai dinner, which cost £14,000. It is very nice to entertain auditors from across all of Europe, but to me that seems like a difficult decision to justify when it is public money.

David Walker: Again, I will make this point once. The Select Committee system of this House depends upon the good will of people who come here voluntarily to give evidence and help you with your inquiries, which we hope will lead to better public policy and delivery. To use me as a guinea pig or a stalking horse for partisan attacks seems to be, to me, a waste of your time, but let us leave that aside. The Eurorai dinner to which you refer was a European auditors’ event that is organised in succession by the audit organisations in membership of the organisation in different years. As has been reported, the Audit Commission’s direct expenditure on this event amounted to some £5,000. If you are saying that national audit bodies—including the NAO, which engages in such activities—should never engage with other national audit bodies then, yes, you will say that expenditure was worthless. If, however, you believe there is learning to be got from other jurisdictions and that we can see something that other people are doing from which we might extract value, it seems to me that, on this occasion, £5,000 was not a lot of money to spend.

Clearly, in the light of the attention paid by the Evening Standard, which is obviously your source for this story today, it looks bad in austerity for there to be a dinner of any kind. Recently, however, I have been round the back of the House of Commons across the road and seen your fellow Members engaging in dinners, which I imagine were paid for either by the public purse or people who wish to secure objects from you. If you as MPs had cleaned the Augean stables thoroughly, you might be in a position to say that a small expenditure on a dinner was completely illegitimate. Until you have done that, I suggest that your criticisms are to be qualified. But I go back to the main point: that particular event had to do with the bona fide activities of the Audit Commission as a national representative body in the audit field.

Q7 Bob Blackman: But the clear point that is being made here is that the rationale for the Government to abolish the Audit Commission is that it has over-reached itself, that it has become a body that does not safeguard public money in the way it should that and it costs too much money to deliver the audit service on which everybody depends.

David Walker: Those are all empirical matters. If we had seen—so far we have not—a plan from the
Professor Heald: There is an important distinction to be drawn about what the Audit Commission did. The Audit Commission regulated audit in the sense it established the audit codes for health and local government. It appointed auditors, and it also acted as a buffer between the auditee—the local authority—and the audit firm. It removed a lot of the issues of liability that a private firm would face. For example, if a private firm were to raise a public interest report on a local authority, it had indemnities from the Audit Commission. The Audit Commission ran its procurement very sensibly in that it put together bundles of local authority audits. The reason why the Audit Commission was established in the early 1980s was that there had been scandals and a fear that auditors were too close to local authorities.

I find it very odd that all the documentation seems to believe that audit fees will come down. The only academic study I know of is by Basioudis and Ellwood in 2005. They very much praised the managed competition audit regime run by the Audit Commission. Therefore, I think the fundamental issues are, first, to keep to the principle that public bodies do not appoint their own auditors, and preferably repair where damage has already been done, and then think about the regulatory function. There seems to be some enthusiasm for putting the Audit Commission in-house practice into the private sector. The Financial Reporting Council seems to think, bizarrely, that that would help to create the fifth major audit firm, which it has been trying to create for some time, but it will also create a remarkable oligopoly of public audit in the private sector.
Q10 George Hollingbery: Mr Walker, you are particularly polemical in your evidence.

David Walker: I thought that your first question was about the transitional arrangements and whether there was a potential danger. Let me address that, again stressing that my experience of the Commission is now dated and in no sense do I speak for colleagues past. My sense as an observer of the public sector is that there is a risk that auditors who are enjoined to produce public interest reports, if they see things happening in the local public space that worry them, might pull their punches during a period when they are distracted. David just mentioned the creation of an in-house audit practice. I would imagine that is absorbing quite a lot of time and energy at a time when, whatever side you may be on in terms of the Government’s unfolding policy agenda, you would wish there to be some quizzical eyes on local expenditure, health and education. I imagine that Andrew Lansley might have wished for a more robust Audit Commission in existence during a period when some fundamental changes are occurring in the local financing of health. That is not the case. So there may be some risks to local public expenditure during the period when, potentially, the Audit Commission is less attentive than it would have been.

Q11 George Hollingbery: Turning to the second part of my question, you are polemical in your assertion that damage has been done by the ministerial whim, as you describe it, of abolishing the Audit Commission without having consulted widely. Has abolishing it in this way done long-term damage to the potential replacement process?

David Walker: Without wishing to flatter you, to some extent you have it in your hands to repair that process. I think it is evident from the Government’s own evidence to you that thinking that should have been much further advanced has not taken place. The thinking that might have been in place prior to 13 August 2010 was not in place. In some sense, the field has been left to you, if you can, to try to put together some of the pieces that at the moment lie, as it were, in shards on the floor. That will be difficult because you are one Committee and clearly we are talking about an arena that is covered by a number of other Committees of this House and other parts of the public sector.

Professor Martin: I think we have already discussed the fact that this was not really an evidence-led policy decision; it was one that happened very quickly. I guess there is some merit in that. We are used to parties that promise localism while in opposition and then rapidly turn round and start to centralise things. As a symbolic gesture that the Secretary of State was serious and meant what he said, perhaps there was some merit in pulling the rug on the CAA, if I can talk about the assessment side for a minute, but one would hope that it was based on some evidence. Though I have struggled to find it, it simply is not there—it is based on anecdotes. If it is on the basis of a discussion about £5,000 on a dinner here and there, that really is not evidence-based policymaking, as I would define it anyway.

Therefore, I think that in this interregnum we risk losing the area focus that the Audit Commission brought through CAA and, to a lesser extent, through CPA. The danger is that we go back to what might be called a silo-ed approach to inspection and we focus on particularly vulnerable groups, as if non-vulnerable groups do not matter and whether they are getting ineffective, inefficient and poor quality services is of no concern. I worry about that possibility. If the field is left to Ofsted and the Care Quality Commission, nobody is looking any more at the impact on areas of joint working, or maybe the lack of it, in the new environment between agencies. The second thing to say is that at a time of austerity, it would be all too easy for local authorities simply to struggle to balance their books, and the absence of a counterweight in terms of questions about whether they are providing decent and adequate services is a concern.

Q12 George Hollingbery: Presumably it is even further complicated by localism itself. The commissioning of services out and third-party bodies providing all kinds of things produces a unique challenge.

Professor Martin: Yes. Third, if we had an alternative model in place before we jettisoned the previous one, that might have been a more sensible way to proceed. As David alluded to, I have been waiting and waiting for the LGA and others to come up with an alternative framework. I visited its website this morning and noted that it had had further discussions in the last week about how it will support councils to regulate themselves. It found that councils feel they will need support and funding to do that. I would not have thought that was a huge surprise. Therefore, there remain big questions about whether we are talking of regulation by the sector or by individual councils. Who will foot the bill for that?

David Walker: Without wishing to flatter you, to some extent you have it in your hands to repair that process. I think it is evident from the Government’s own evidence to you that thinking that should have been much further advanced has not taken place. The thinking that might have been in place prior to 13 August 2010 was not in place. In some sense, the field has been left to you, if you can, to try to put together some of the pieces that at the moment lie, as it were, in shards on the floor. That will be difficult because you are one Committee and clearly we are talking about an arena that is covered by a number of other Committees of this House and other parts of the public sector.

Q13 James Morris: To concentrate on the alternative framework that you are discussing, irrespective of discussions about the abolition of the Audit Commission or not, the Government’s policy driver is to leave accountability for local spending much more in the hands of local people. To focus for a moment on the audit side, do you think there is a legitimate argument about how the audit function could be reduced, the nature of the way in which audit is done, and how it can be oriented towards making local people the primary point of accountability rather than a heavily top-down centralising body?

Professor Heald: Are you talking about audit as opposed to inspection?

Q14 James Morris: I am just focusing on audit.

Professor Heald: There are fundamental differences between private sector audit—I am not talking about whether the audit is done by a private or public sector
issues about non-audit services for local authorities. There are no comparable data. The same kinds of
cheerleaders rather than anything else, particularly if one thing we can expect is a lot of locally
auditing. I make two points about that. First, if the so-
go. Reading the evidence you have received, there are
needs to be very clear about which parts of that will
remit. The big change over the last 30 years has been
additions to that, particularly about regularity and
probity. Public audit of itself has always had a broader
remit. The big change over the last 30 years has been
the expansion of value-for-money auditing. So if
people talk about narrowing the scope of audit, one
needs to be very clear about which parts of that will
go. Reading the evidence you have received, there are
a lot of people who want rid of value-for-money
auditing. I make two points about that. First, if the so-
called centralised view of value for money is rejected,
one thing we can expect is a lot of locally
commissioned value-for-money reports acting as
cheerleaders rather than anything else, particularly if
there are no comparable data. The same kinds of
issues about non-audit services for local authorities
that we get in the corporate sector—

Q15 James Morris: If I may cut across you, do you agree that in the past 30 years—perhaps in the 1980s
when the Audit Commission first started up—there
was a legitimate concern about some aspects of audit
and the performance of local authorities was generally
seen as being quite poor, but we now have a situation
where the general standard of probity and
performance in local authorities is very high?
Therefore, is there not an argument that from a policy
perspective we need to reduce that level of centralised
inspection and audit so that we move forward to the
next stage, and that we do not need the heavy-handed
approach that we needed 25 years ago?
David Walker: Personally, I think that is absolutely
on the right tracks. In the age of austerity, to use the
cliché, there are a number of ways in which the cost—
some would say the burden—of audit could be
reduced. The thinking is that the professionalism of
auditors lies in financial probity, regularity, and fair
and true assessments. Let’s try to keep them on that
track and strip away what has accrued over the past
25 years—certainly during the lifetime of the Audit
Commission—with the wider effort to subject them to
a performance management regime on the one hand
and value for money on the other. I am afraid I have
never been entirely convinced that auditors
necessarily possess expertise in value for money. In
the private sector, that is not what auditors do. I have
never been entirely clear at what point the public and
the Audit Commission thought that auditors could
take on what would turn out to be some rather tricky
judgments that arguably should remain within the
purview of the people elected by the public to look
after local authorities—i.e. councillors.
Professor Martin: I am not well placed to talk about
audit as I think I have already made clear but, try as
I might, I remain sceptical about the idea of local
people taking on a role that has been left to
professional auditors or inspectors until now. There is
a variety of reasons for that, but it runs counter to the
local political culture in most parts of the country.
We have done research to look at whether local people
say they would like to have greater involvement, and
typically 20% to 25% of those who respond to
household surveys say they do. When you ask how
they would like to become more involved, it is
probably filling in a survey once a year about how
they feel about their rubbish collection or something
like that, so the capacity and willingness of the local
population to get closely involved in scrutinising these
sorts of issues is very limited at the moment.
Secondly, we all know that there are certain groups
who are more inclined to do that than others.
Therefore, people over 65 are more likely to want to
get involved and people in socio-economic groups A
and B are more likely to do that. Third, there is still a
huge misunderstanding about what it is local
government is responsible for and how it is funded. I
think that most people assume that the council tax
pays for most local government services, which
simply is not the case.
Therefore, there is a whole job to be done, first, to
raise awareness among the public about these issues
and, secondly, somehow to stimulate an appetite to get
closely involved. I think that without comparative
data, which is how most people consider whether they
are happy with performance, it will be quite difficult
to do that. What question will I reasonably want to
ask of my local authority? I might want to ask: are
things getting better over time? I am not sure how I
am going to know that yet under the new regime,
whatever that is. I might want to ask: are things as
good here as they are over there? It is certainly unclear
to me how those comparative data will be available
and who will provide them. Thirdly, I might want to
know: can I trust this source of information, is it
independent and has it been verified by somebody? It
is still unclear to me how that will be provided.
I think there are questions about appetite, capacity and
the kind of evidence that will be available to people
to enable them to do that. When we looked at the
Oneplace website last year, we found that 1% of the
1,000 or so in the representative sample of local
residents across the country who were interviewed
said they had actually visited the website, which the
Audit Commission put up specifically for the purpose
of providing information about how good local public
services were in a particular area. It seems to me to
be a fantasy.

Q16 Simon Danczuk: Mr Walker touched on the issue of public interest reports. The Secretary of State
has implied that they will continue in the brave new
world of local government audit—or a dog’s dinner;
call it what you what you will depending on your
perspective. Is there a need for public interest reports?
How might they work in this brave new world? Who
will commission them and how will they be
delivered? Will they have any real value?
David Walker: This seems to me to be a point of
departure in terms of where one takes the argument.
If you are a localist who believes that legitimacy has
been given to elected local councillors because they
have the courage to stand for election and secure the
assent of local people, you could quite clearly argue
that an auditor had no right to blow a whistle and that
is a job for the local political system—local
newspapers, opposition councillors and so on.
However, if you believe—this is a view that has been
taken by this institution since before Queen Victoria
came to the throne—that local expenditure is precious
and demands constant invigilation by experts, you
would say that there probably needs to be a state
capacity to blow the whistle.
I suppose that one of the practical questions now is:
who might be best placed to do that—a revamped
National Audit Office or some other body? One of my
problems with a 100% private provision of audit
would be the risk that private auditors—we have the
example of the banking system on our doorstep—
would never be enthusiastic about blowing the whistle
and potentially losing future revenue for their firms.
Therefore, there are two questions. One is whether the
principle of whistle-blowing and public interest
reports is answered; and, secondly, if we are to have
that, who will do it?

Q17 Chair: Are there any further comments on that?
Professor Heald: This goes back to my earlier answer
to the point that the Audit Commission protected the
private auditors—the regulatory function of the Audit
Commission protected the private auditors. I do not
know the numbers, but in the evidence there is
reference to fewer public interest reports since
foundation trusts were established. You might usefully
look into what the pattern has been.
The other point I make is that localism is all the
fashion, but one of the things one must remember is
the extent to which local authorities are funded by
money voted by Parliament. Parliament will have an
interest. What is quite remarkable is the way in which
everybody seems to want to shuffle new functions on
to the National Audit Office without Parliament
having been consulted. It seems to me very important
that if the National Audit Office is to acquire any more
functions, it should be done explicitly by Parliament
rather than by mission creep on the part of the
National Audit Office. Under the previous
Government, I kept criticising the fact that the then
Comptroller and Auditor General had taken on the
role of auditing the assumptions underlying the
macro-economic forecasts when I doubted whether
the Audit Commission protected the private auditors.
I do not think there should be a state
capacity to blow the whistle.
Q18 Chair: Professor Martin, do you need to add
anything?
Professor Martin: No, thank you.
Q19 Mark Pawsey: We have heard your criticism
that the Government’s decisions have been made in
haste and that you believe there is an absence of a
detailed alternative, but, Mr Walker, you told us that
there is now an opportunity for us to create a new
framework. To move the discussion a little further
forward, what would you define between you as the
principles that need to be retained within a new
system? Would you set a minimum requirement or a
series of models that different authorities can choose
to use? Where do we go from here?
Professor Heald: I do not think there should be a
choice of models for authorities to use. As far as I am
concerned the Sharman principle holds: public bodies
should not appoint their own auditors. That would be
my real bottom line. There is now an issue for
Parliament. I was a member in Scotland of the
Financial Issues Advisory Group that considered
financial accountability to the Scottish Parliament—
actually before the Scottish Parliament was created.
There was a very substantial discussion in the
advisory group about whether Scotland should have
an equivalent of the Audit Commission and also of
the National Audit Office. We came to the view, after
quite a lot of discussion, that Scotland was just too
small to have two audit bodies. Although we were
conscious of the constitutional argument that local
government had its own accountability, we thought
that having two audit bodies would be too
complicated. There is a rather odd structure in place,
which has actually worked quite well in practice.
Therefore, one of the inhibitions for unifying public
audit in the UK has been the sense of the separate
democratic mandate of local authorities.
I would certainly argue that Parliament should think
very carefully now, having got to this position, about
whether there should be two separate bodies. What I
do not want to see happening is the National Audit
Office being lumbered with a lot of additional powers
that will deflect it from its major mission. It has to be
something that Parliament itself decides. This has
significant implications for the National Audit Office
that it is important for Parliament to understand. If, as
the Minister says, the Audit Commission does not
have to have its own employees doing audit, why does
the National Audit Office need its own employees?
Why could not all of that be contracted out? Equally,
if we do not need value-for-money audit in the local
authority sector, why do we need it in the central
Government sector? We come to a point where
Parliament can have a fundamental debate, very much
like what happened in 1983.
David Walker: I agree entirely with that. It must be
for you to answer whether public expenditure,
particularly under the movement towards Whole of
Government Accounts, is to be considered a unity, or
whether we think of it as a bit here and a bit there and
so we can have separate audit regimes. If you do not mind, I was struck by a phrase in the annual accounts of Rugby borough council, which says: “Central Government has effective control over the general operations of the council. It is responsible for providing the statutory framework within which the council operates, provides the majority of its funding in the form of grants and prescribes the terms of many of the transactions that the council has with other parties”. As long as that is the case—I think that is a reasonable description of it—David’s strong assertion of the need for a unified audit regime, however practically organised, is a compelling one.

Q20 Mark Pawsey: But if the proportion of funding from central Government falls, does it not mean by implication that the amount of input from central Government should equally fall?

David Walker: Absolutely, I think that if Eric Pickles’ review turned up a new model so that 80% of local expenditure was raised locally as opposed to 20%, the intellectual case for local authorities to choose their auditors would become strong, if not compelling. At the moment, however, we are not there, and I wonder whether we will ever get there.

Q21 Chair: Why? Surely, from the public’s point of view, it is their money.

David Walker: If the local public are the principal source of the money, it is the local political space in which accountability and value-for-money questions, and indeed audit arrangements, are to be addressed. As long as that money comes from central taxpayers through distribution systems including the non-domestic rate, surely it is for the central part of our state—the legislature—to assure itself that that money is spent according to law. That is the basic purpose of it.

Q22 Mark Pawsey: How would you define the minimum requirement, which is the bit by which it would not reduce at all—the bare minimum where we would expect central Government to involve themselves in the affairs of local government as far as concern audit and inspection?

David Walker: Let’s see whether there is any genuine move to increase the proportion of local expenditure raised through local taxation. Unless and until that policy changes, I think that this is an academic discussion. We really have to deal with where we are, which is that local expenditure is willed by national taxpayers and channeled through this body.

Q23 George Hollingbery: NNDR is almost certainly going to become an even larger part of local councils’ revenues, and local councils may well get control of how much they raise. Therefore, I think your question is somewhat answered. Certainly, it seems that a lot of that money will be coming locally. However, is not the ultimate extension of your argument that local taxpayers ought to be in charge of appointing the auditors?

David Walker: Indeed; discussions have taken place along those lines. If the precedent that David Heald quoted of foundation trusts is prayed in aid and if the example of academy schools is on the table, it will be hard to say to councils that they should not have the right that the governors of schools or the trustees of further education colleges have. Obviously, there are those who find it problematic that such autonomous bodies have the audit arrangements they have but, as things stand, for them to have choice of auditor and for local authorities not to have it, were they to secure more autonomy in their funding, would be difficult to argue.

Professor Heald: I do not accept my fellow witness’s point. The principle that public bodies do not choose their own auditors applies irrespective of whether they are funded by local or central taxes. The point I made earlier was that if you are in a position where they are funded mostly by local taxes, the argument about having a separate local authority audit regime, as we have always had in the past, becomes stronger. I was not making the argument of merging the Audit Commission’s responsibilities with those of the National Audit Office. I was saying that this was an opportunity to discuss them.

Q24 Mark Pawsey: But in that scenario who would decide who the independent auditor should be? Accepting your premise that the body itself should not choose the auditor, who would choose: local people, or would Government impose it?

Professor Heald: You need some kind of audit regulator. It could be done either by an expanded National Audit Office, although there are dangers in going in that direction as I pointed out, or by some kind of residual Audit Commission.

Q25 Chair: Professor Martin, do you want to add something?

Professor Martin: No.

Q26 Stephen Gilbert: Perhaps we can drill down a bit on some of the last points you made. Professor Heald, I take your point very strongly that the auditor can never be independent if appointed by the local authority; you could never guarantee that level of independence. I would appreciate a comment from all the witnesses about that. The Government have said they will put in place stringent safeguards. Can you imagine what those safeguards could be while allowing local areas to appoint their own auditors?

Professor Heald: Without departing from my point of principle, I presume the safeguards will be in terms of things like non-audit work. That would be one of the issues. There would also be issues to do with liability insurance. They would probably be the major issues. The point I made before is that one of the functions of the Audit Commission was to protect the private sector auditor as well as its own staff. One of the reasons why I am sceptical about audit fees going down is that the private audit firms and whatever happens to the Audit Commission in-house operation will have to buy insurance in the market. This means that some councils may find it very difficult to get auditors. My prediction is that if one went to a position of councils choosing their own auditors, there would be a remarkable rush to hire the big four for the same kind of reputational reasons that other bodies,
including universities, do so at present. One of the things the Audit Commission and Audit Scotland have tried to do is build up alternative providers in a managed market.

Q27 Stephen Gilbert: Therefore, notwithstanding the point of principle, which accept is a very legitimate viewpoint, you can imagine a system of safeguards that enables the auditor to have independence when he or she goes into the local authority and undertakes the inspection and audit?

Professor Heald: It depends on what you are covering. One point I have already made is that if you get rid of centralised VFM where there is an attempt to build comparable data, what you will get is a lot of cheerleading reports about how wonderful your particular authority is, just in the same way universities and public bodies get economic consultancies to show what an enormous economic impact they have on their areas.

David Walker: I am sorry to interrupt. That may be a true criticism of a university or foundation trust, for example, but surely the very nature of local government is its contestability. You will have things called opposition councillors who have a vested interest in subjecting the auditor to the rigours of cross-examination. To that extent, the local political space, just as at the centre, should at least in theory provide an opportunity for pluralism and checking the quality and probity of auditing in a way that the auditing of private companies—in a different context—and other autonomous public bodies does not.

Professor Heald: One other point I come back to is that the power to object to local authority accounts is very little used at the minute. Certainly, there is some suggestion that it should be abolished. That seems very odd at a time when people talk about armchair auditors and publishing everything over £500 because if anything was to stimulate the use of that power, that would seem to be it, whereas the emphasis seems to be on a power to object to the appointment of the auditor. Except on issues like non-audit services, it is difficult to see how you can get a valid objection to somebody on the list of approved auditors. Obviously, objections are very time-consuming and costly for the auditor, particularly if they are argumentative or technically difficult.

Q28 Stephen Gilbert: That point may come up in a little while.

Mr Walker, you indicate that you can see the potential that, because local government has the political space—because there are opposition parties and administration groups, and because it is contested—you could outsource this function to local areas and still provide a significant level of security of independence.

David Walker: The critical question for us all, but particularly to you in your deliberations, is whether local authorities are trustworthy. To use language that to people who are localists immediately sounds patronising, why are not local elected members as capable of rigorous examination, whether it is on taxation or expenditure, as Members of Parliament or Members of the House of Lords? If we believe that local government is and should always be in a relationship of tutelage to the centre of government, the nature of the regulation of local government audit is very important. If, however, you believe that councillors are capable of autonomous decision-making about taxing and spending, it is quite legitimate to ask about the practicality of who appoints auditors, but it seems to follow from that that audit appointment should be left to local decision making.

Q29 Chair: Should there be an additional requirement, or at least an indication of good practice, if we get to the point of councils appointing their own auditors, that perhaps there must be an audit committee on which there are people who are independent of the council, maybe even with an independent chair, who would do the appointment and have final say over the dismissal of an auditor?

Professor Heald: There is no statutory requirement for audit committees, but some authorities have audit committees with independent chairs, or with a member of the opposition as the chair of those committees. But you can imagine the kinds of argument that will arise. The localist argument is that the councillors are elected people. In many local authorities, it will be very difficult to find lots of people who are technically qualified to sit on the audit committees of local authorities and potentially get themselves into a position of considerable personal risk.

David Walker: I am not sure that audit committees are a remedy. Ultimately, I would have to vest faith, in your case, in the political economy of the city of Sheffield to be able to produce a conversation that would subject the decisions of extant councillors to interrogation, examination and rebuttal as necessary. If an authority were in the control of a single party for ever and ever—there has been examples of that in the past on all sides of politics—it might pose problems, which arguably the Standards Board, now abolished, might have answered, but leave that aside. Most local authority areas are subject to the give and take of politics. I am not sure why the give and take of politics should not be as effective a deliverer of decent decisions about audit as specialist committees, particularly those involving the appointment of people who have no standing other than their proclaimed independence.

Q30 Bob Blackman: Often when audits take place, the local newspapers come in and trawl all over the accounts. That acts as a means of allaying fears, if there are fears, or exposing any problems. Is that not an alternative route forward?

Professor Martin: I am glad you have raised that and that my colleagues have raised the issue of councillors. I thought that earlier we were in danger of having a debate that was about either top-down performance management by Ministers or armchair auditors. I think there are other players somewhere in the middle of this mix. To the extent that we are saying it has to be either of those two, we really are saying we do not trust local councillors to do the job
they are elected to do and that there isn’t adequate media scrutiny. If we take councillors themselves plus a series of intermediaries, which might include the media and a range of voluntary and user representative groups—not your average citizen, but people with the time and capacity to get the knowledge that is needed to hold authorities to account—that is where the alternatives to the previous regime are likely to be found, so I agree with you.

Professor Heald: Obviously, traditionally, the local media have played an important role in this, but one of the significant issues is that local authority accounts are very complex. It is not just that they have become more complex as accounting has become more complex with the move to international financial reporting standards, but there is also a dichotomy between the bottom line of the IFRS accounts and the council tax numbers. That is something that Parliament should think about. There are lots of adjustments and add-backs to make sure that things such as depreciation do not come through and hit the council tax bill. One of the things that distracts the attention of councillors and members of the public from the actual audited financial statements is the fact that they are not the numbers that determine what the council tax bill is—that is what hurts. I think there is scope for thinking through all the paraphernalia of legislation about the way local authority accounts are dealt with. Obviously, it is partly to do with the way the Treasury counts public spending numbers.

David Walker: But all those points apply to the expenditure and accounting of central Government. Whole of Government Accounts, national accounts and Government budgeting are three sets of numbers that do not cohere one with another. That is a point to make, but it is by no means applicable to local government.

Chair: That is a very fair point having looked at the accounts for the CLG and its estimates.

Q31 Heidi Alexander: What is your view on whether the demise of the Audit Commission will result in greater competition in the audit market and reduced fees, and how we can obtain value for money in local authority audit in the new world?

Professor Heald: I think you have to distinguish between audit doing less and bringing fees down because auditors do not do as much, for example on the value-for-money side and inspection side. I can push that aside for the moment. Anything one does is speculation. My speculation is that there will be upward pressure on fees. The evidence I have seen is that the Audit Commission managed the market quite well through its framework agreements, pulling in new firms, bundling sets of auditors and a certain amount of cross-subsidisation within the bundle. Therefore, there is a danger that audit fees will go up quite sharply for some authorities. It may be that local authorities that are geographically remote or regarded as politically risky are particularly hit. To repeat a point I made before, one of the things that one will find is that people want the big four. Given that all the major authorities will want to be audited by one of the big four, you might get more concentration. There is much less reason for audit concentration in the public sector in the UK than there is in terms of UK corporates. UK corporates are very internationalised; you need an enormous network of international representation to be able to audit a big UK corporate, but there is also a reputational factor as to why 99% of the FT100 is audited by the big four. I think that unless the matter is managed well, we will see more concentration and audit fees probably going up.

Q32 Heidi Alexander: What do you think should happen to counter that?

Professor Heald: The managed market should be kept. One of the functions of the Audit Commission—the same applies to the Wales Audit Office and Audit Scotland—was that its ability to manage the market depended partly on having its own in-house provider, so the fact that it had the experience itself and could do its own internal costings made it much easier for it to manage the market. I do not agree with putting the Audit Commission practice into the private sector, certainly as one unit, but whatever is decided on that issue, one needs to keep managing the market—one needs a credible market manager.

David Walker: If I may add to that and endorse the point, unless we think about the content of audit, the scope for savings is inherently limited. We should be thinking about the content of audit, particularly the question of whether auditors should do value-for-money and financial resilience questions, which are not part of the usual audit package. Then there is the rather technical question about the relationship of internal and external audit, which we have not touched on. There are clearly ways in which internal audit regimes that are regarded externally as reliable could reduce the cost of external audit. If we are to trust local authorities more, perhaps their internal controls could carry some of the weight that is presently carried by external audit.

I suppose that the answer to your question is that as things stand, with public audit being defined as it is, there are too few bodies around. Given the likely division of the market, it is easy to see how cost pressures could put up the price of audit in the short and medium run.

Professor Martin: I suspect that you make the savings by cutting back on the assessment and inspection side that we have had until now. There is a variety of ways to do that. One is simply not to do it any more and run the risk that services decline, or something horrible happens to a user somewhere. There is that risk-reward ratio to be evaluated. Another way of dealing with the assessment and inspection side is to think about the key tasks involved in that. You can divide them up into three. Somebody has to determine what the standard should be—what is a good, adequate level of service. It might be left to local councillors to decide what is appropriate in their areas, so Ministers may no longer have to do that.

Having done that, you need to gather information that enables you to know whether standards are being met. It is quite conceivable that the local government sector could do that for itself, although there are questions about the reliability of those data and the willingness of that sector to take on the costs of doing that. Third,
there is intervention, or some kind of remedial action, where things are not going well. Again, there is a variety of stakeholders who could take on that role. You could leave that simply to the local authority itself. In theory at least, you could leave it to the sector, or you could have a central body doing that. I think I would be asking questions about whether we need any form of external assessment of services and, if we do, who is best placed to do that in a set of changed circumstances. You could partition the role in a variety of ways.

Professor Heald: From a local government perspective, I would be most concerned about the fact that there are reputational risks to the sector from the failure of individual councils. I would be very worried that the failures of individual councils would hit the reputation of local government and that one would just see central Government removing functions from local authorities.

David Walker: There is a tendency to exaggerate the cost of audit itself and to marry audit with various other inspecional functions. Off the top of my head, I would imagine that the annual cost of audit to the London Borough of Lewisham, which has a budget of about £400 million, is probably no more than £120,000 or £150,000. Obviously, what adds to the cost is preparation for and receiving inspections and, at least until it was abolished, the performance management regime of the Audit Commission. They certainly added to the cost, but audit as audit represents a very small fraction for a major authority. There is a different set of equations in district councils, where you could argue that audit is too large in terms of the budget, but I think that for a major city authority, audit is not financially terribly significant.

Q33 Mike Freer: I turn back to the advent of the armchair auditor crawling all over local authority accounts. I want to paint two scenarios and I shall be interested to know whether you think I am too pessimistic. First, there are local authorities who are scared to spend money because of the wrath of the armchair auditor. For instance, if my memory serves me, the Children Act required local authorities to link their IT systems to their own social services teams, hospitals and the police. Of course that costs money. Then you get the headline “Council spends £50,000 on IT” and the armchair auditors and local papers scream blue murder, yet when a child is damaged or hurt, the council is criticised for not investing in IT.

How do we square that circle? I have some scars on my back from my own local authority. Where armchair auditors use section 16 of the Audit Commission Act to challenge accounts, are we not then giving a charter to people who are obsessive and narrowly focused simply to harry and pursue the local authority on a very narrow issue, rather than a genuine army of auditors scrutinising £500 spent on this, that and the other?

Professor Heald: I sympathise with your first point. Personally, I would not have given great priority to publishing raw expenditure data, partly for the reasons you have set out. One of the things professional accountants do is process information and what we need to do is make things much more intelligible to people. The research I have done myself suggests that the object of power is not much used in those places. It is sometimes used by obsessives, but you can see that to take that away from electors might be seen as an important issue.

Clearly, on the armchair auditor point and your question about a particular spend on IT in connection with children’s services, councils will spend a lot more time thinking how they label things because of the fact that it flashes up on a screen. I do not mean they will mislabel things, but people will think much more about whether the short description makes any sense in the public domain, so there will be considerable compliance costs. Obviously, this is driven in part by the availability of web technology. It used to be quite difficult to get local authority accounts sent to you as an academic accounting researcher. Most authorities now post them on the web. I think we should wait and see, but it is not a substitute for professional audit.

David Walker: I confess a certain amount of hesitancy in riding to the rescue of Eric Pickles, not that he needs me to, but it is very early days. It is only since 1 January that there has been a requirement on all local authorities in England to produce itemised transactions down to the level of £500. Clearly, there will be a period of adjustment when the green ink brigade will pore over them, but after a period of time it will probably settle down and we are likely to see web applications and technology producing a more sophisticated rendering of such figures.

It is easy for me to say this, but you stood for election. Politics is partly about education, isn’t it? Elected politicians—central or local—are in the business of what might be called fiscal education. They tell people that whether they want to reduce or increase the size of Government, there is a case for doing it, and that there is a trade-off between taxation and the services that taxation buys. Surely more information is a potential way to enrich that conversation. Clearly, there will be lots of scars in the process, but ultimately we have to believe, don’t we, that more information will make democracy more effective?

Q34 Mike Freer: I understand the point but I am not convinced there is an army of armchair auditors waiting to pounce on a council’s website. There will be some, particularly those who have time on their hands, which means that they may have slightly more of a skewed interest, if I may put it as diplomatically as that.

Professor Martin: You will have heard from my earlier answer that I have lot of sympathy with that. If we were determined to be positive for a moment, this new era might mean that councillors have to do much more of what David has just described and explain the reasons for the decisions they have made in terms other than just, “Central Government has handed out the money and has told us to do this, that and the other to respond to this top-down performance framework.” I suspect that the sector is about to get some of the benefits and also the challenges of a sector-led regulatory framework, if that is what we actually see in place. That will require local councillors—or officers if councillors cannot or
Q35 Bob Blackman: Moving away from audit to positive side effect. political discourse, which will be an interesting and think those kinds of things could reinvigorate local population to trigger a non-binding referendum. I alongside some of the provisions in the Localism Bill, decisions they have made, particularly if you put that will not do it—to engage in a dialogue even with the awkward squad about why they have made the decisions they have made, particularly if you put that alongside some of the provisions in the Localism Bill, such as the ability of a relatively small minority of the population to trigger a non-binding referendum. I think those kinds of things could reinvigorate local political discourse, which will be an interesting and positive side effect.

Professor Martin: It is very hard to answer that in the abstract. It depends on whether we can come up with a system in which local people have any confidence and on whether, if it is the sector that leads, it is willing to get down and dirty in those cases where there is a need to sort out a serious or persistent failure, and that comes back to the reputational risk that David was just talking about. I have the pleasure of living in Wales. The experience of the Welsh performance framework over the past 10 years, where it really has been that the Welsh Local Government Association has been looked to to intervene in difficult cases, is not too promising. Therefore, the ability of a membership organisation to intervene in some of its own members, if I may put it that crudely, is a serious question for us to answer. What happens to those members who are in the process of thinking about disaffiliating under a sector-led regime?

Q36 Bob Blackman: One of the arguments put is that the process we have had leads to continuous improvement. People examine how well they are doing and compare themselves with others. Is there a risk that all that will go completely out the window and people will happily coast along thinking everything is okay?

Professor Martin: It might be difficult to coast in the current financial circumstances. Perhaps one too-cynical argument is that we do not need the driver of inspection—if I can use that phrase—any longer, and if you are still standing in two or three years’ time, you are probably quite a well managed local authority. I can buy into that. Therefore, at a time when there were large real-terms increases in spending on local public services, perhaps it was right to scrutinise what was happening to that central Government largesse. In the current climate, perhaps that is less necessary, but as I articulated earlier, my concern is that some authorities will simply cut and look for efficiencies, and worry far less about quality of service.

Q37 Bob Blackman: Should there be a position emerging where there are a small number of key performance indicators with which every authority should compare themselves so the public can see how authorities x and y are doing in these five areas, rather than the enormous number of different regimes that seem to have been forced on local government?

Professor Martin: My personal view is that there is a good case for that. However, those kinds of plans usually run into objections from local government professionals, all of whom want some performance indicators in their areas. While corporate policy officers, chief execs and perhaps even finance directors would sign up to that. I think the moment you take away from a highway engineer or planner her or his Pls, you begin to run into those professional kinds of lobbies. Therefore, my answer is yes in theory. It will be interesting to see whether or not the local government sector is up for that.

Professor Heald: If I may disagree with one point that has just been made, I think that the present climate is much more dangerous. When authorities face very big spending cuts and certain parts of the public sector are undergoing institutional upheaval, it is the wrong time to withdraw inspection. I think that peer review, which is one thing people stress as part of self-regulation, is important. I did some work on the use of resources assessment, which is a subset of comprehensive area assessment. One thing that was quite clear was that there was a good deal of collaboration and peer review going on within the broader framework. People were discussing it with each other. Again, to come back to a period of big spending cuts, I can imagine the political leadership of a council becoming unnerved by its officers spending a long time out of the office in somebody else’s authority. The final point I make is that, at the end of the day, Parliament and the National Audit Office’s Comptroller and Auditor General will want satisfaction that the money is being properly spent and accounted for. It also depends on what you mean by self-regulation. The problem of self-regulation, taken literally, is whether Parliament would have sufficient confidence in the system. If Parliament does not have sufficient confidence in the system, the danger for local authorities and local bodies is that it will just seize back the function.

Professor Martin: To be clear, I was articulating—maybe in too flippant a way—the view that cuts and financial austerity might drive improvements. I am not at all confident of that, so for me the removal of inspection from all but, say, education and children’s services is a huge gamble.

Q38 Bob Blackman: Is there any risk, with authorities now either sharing services or contemplating doing so, that the auditing and inspection regime for those might become confused?

David Walker: Absolutely. You need to have this conversation with your party colleagues in
Westminster, Hammersmith and Fulham, Wandsworth, and Kensington and Chelsea who have led the way in proposing some radical service-sharing arrangements. Presumably, they would reply, “We are content that the local democratic process, possibly involving a merger of some of these boroughs, would be sufficient to secure the accountability needed.” I have to repeat that, in a sense, that is one decision that you as a Committee will have to confront. Do you believe, as the Government seem to believe, that radical localism is on the cards and that we can and must entrust responsibility to local elected members, or do we need to retain, despite the abolition of the Audit Commission, a regime that may embrace performance indicators but certainly does not look that different from the previous regime? Are we not at some kind of junction here? If one decides that localism is the zeitgeist and the wave of the future, one can quite safely get rid of the Audit Commission, but not only that—why have five PIs? Why do you need any PIs if you are prepared to trust elected local government?

**Professor Martin:** I think you need five PIs so that local people can make some kind of comparative assessment, if they are to have any say in the thing at all. Otherwise, how else do you achieve it?

**David Walker:** I think the Government’s answer would be—far be it from me to speak for the Government—that voluntary organisations that work in more than one local area, data mashers and Dr Foster-type bodies would all swim in and provide the comparative data that arguably a bureaucracy has previously provided.

**Q39 Chair:** Are you not convinced?

**Professor Martin:** I am lost for words.

**Q40 Heidi Alexander:** I want to turn the discussion to the advent of serious service failures in authorities. In a new inspection-light regime, what do you see as the key critical safeguards that need to be in place to identify where service failure is happening or is likely to happen, and then the intervention required? What do we need to put in place given this new inspection-light regime?

**Professor Martin:** It seems to me that even the most localist Government that I can imagine will not be willing to abandon some of the most vulnerable groups to the ravages of localism, if I may put it like that. The postcode lottery and the public’s tolerance of that is yet to be tested, but I suspect that the public expect to have fairly similar services in different parts of the country. I think the Government will propose—I guess we would support that—the idea of some minimum basic standards for particularly vulnerable groups. After that, if we go down a sector-led approach, it is up to the sector to set the standards and to have the right detection mechanisms in place. The truth is that I do not know what they are until they have been more clearly specified by the architects of the new regime.

**Q41 Heidi Alexander:** Do you anticipate that the sector-led approach will be enough and effective in terms of a local authority’s corporate responsibilities and ability to govern?

**David Walker:** We have some evidence. You may or may not take oral evidence from the Audit Commission—it will give you chapter and verse—but the story is that in the case of the metropolitan borough of Doncaster between approximately the end of 2008 and last year, attempts through sector-led peer reviews to help elected members and the mayor to cope failed, so an external intervention was necessary, which was finally signed off by the present Secretary of State. I make the observation that as an employee of the Audit Commission I was never entirely clear that, as an audit body, it was entirely apt for such governance review and so on, but your point stands. The need for it was undeniable. Things had gone badly awry in that particular place, and support, help and external intervention of some kind was necessary. Therefore, I suppose the answer to your first question must be that we lack sight of what that regime could be. I am not at all assured that an employee of KPMG or Deloitte, however intelligent, could ever have the standing to make the kind of subtle political intervention that an external public body would need.

**Professor Martin:** I go back to what I said earlier. There is a difference between gathering the information that enables you to identify a problem and taking some kind of action to address it. Both of those are quite difficult to do from the inside.

**Q42 Simon Danczuk:** There is an argument that CAA helped to encourage local agencies to work more closely together. What will be the impetus for that now CAA has gone?

**David Walker:** Briefly, one of the sadder aspects of the change of government—I do not say this with any partisan spirit—is that that impetus towards joined-up working, both at the centre and locally, has dissipated. That is not to make a case for the retention of CAA, which had lots of issues around it, but there seemed to be a real push for social services departments, education departments and corporate centres to come together and work across boundaries. That seems largely to have gone. I fear the answer to your question is that local authorities will retreat further into themselves in many cases, and into departments within them.

**Professor Martin:** I agree entirely with that answer and so will other agencies. Therefore, you would expect health perhaps to pull back into its silo, and that the police, fire and rescue and the probation services will do likewise. Talk of joined-up solutions or services, and perhaps even the elimination of duplication in the way that I understand was intended in some of the Total Place pilots, seem to be off the agenda for now. It is not clear what it is that will put that back on the agenda.

**Q43 George Hollingbery:** I am very surprised to hear you say that. Government Ministers who have sat before us here have said totally the opposite. On what are you basing that assertion? I put that to both Mr Walker and Professor Martin. We have heard it asserted any number of times by the Government that
they are very keen on the Total Place idea and on cooperation between services, with the breaking down of silos and forcing Government Departments to work together at a local level. I do not recognise the picture you paint.

**Professor Martin:** I suppose that what I am observing is the loss of impetus for that. What are the incentives now for very hard-pressed local public services to work together?

**Q44 George Hollingbery:** In my locality, a number of projects are happening because they are hard pressed locally, to some extent, but clearly there is also an agenda in government to continue with the Total Place theme at least. That is my understanding anyway, and certainly the Government are on record as saying so.

**David Walker:** Total Place would have led to a financial dimension—some kind of budget, or even a shadow budget—that allowed services in a given area to see that there were ways to transfer money around. That did not happen. We may say that the fact that the name’s changed is not important, but the important element of Total Place was an attempt to say that there is a common pool of public expenditure in an area and that savings might be made if that pool were genuinely shared among a variety of bodies—not just departments of the same local authority, but between the local authority and other public agencies. To the best of my knowledge, the impetus that had been building seems to have disappeared.

**Q45 George Hollingbery:** Not three weeks ago, the Minister for Decentralisation sitting in your very chair said precisely the opposite. He said he was waiting for innovative plans to come forward from local government and other public sector employees to do exactly what you wish they would do.

**David Walker:** That is one Department that, as I say in my evidence, has not always been the best at securing joining up here at the centre of government. I wonder whether he would genuinely say that he had purchase on the policies and delivery of the Department of Health, the Home Office and the Department for Education. That is as much where things need to be joined as locally. The movement behind that seems to have disappeared.

**George Hollingbery:** I did ask him exactly the same question.

**Q46 James Morris:** One of the manifestations of comprehensive area assessment is the Oneplace website. Mr Walker, I think you said earlier that we are living in a time of social networking and information circulation, and that people and citizens look to be able to take information and use it in the way they want to use it. Was not one of the weaknesses of the Oneplace website and the approach that the information was too static and that it existed in an information hierarchy? There was no way that I, as a local resident of Sandwell or Dudley, could go to it and manipulate the information in the way I wanted. Was that not one of the weaknesses of the CAA approach?

**David Walker:** To be fair, it was launched in December 2009. With the best will in the world, we had only a matter of months to begin. The plan certainly was to move into all kinds of accessibilities and manipulations. You might tell your colleague that one of the purposes of the expenditure under the communications rubric was related precisely to programmes of software and IT to try to make static data—you are right—capable of being manipulated much more easily. I hope that, with time, we would have made some progress on that. But you are absolutely right that all of us in the political class—politicians and journalists—have to take a pace back and see what the public themselves can do off their own bat. One of the cases for the release of data under the previous and present Governments is to allow some freedom of approach, provided that there are still standards that allow genuine comparability and ensure that the data provided are reliable.

**Professor Martin:** The research that we did on CAA flagged up that those people who went to the Oneplace website were pretty happy with the information they found there. Therefore, while your question feels intuitively right, people were not demanding the data in very different forms. Maybe they have not become demanding enough yet, but the challenge was, first, to raise awareness of the existence of this information and, secondly, to stimulate any desire to go and look at it. It was not the case that people looked at it and said it did not tell them what they needed to know.

**Q47 Simon Danczuk:** I want to put a question about the impetus for local working that is related to your point but is broader than the website. Taking the example of Rochdale, where I am an elected Member, that was identified with a red flag as being particularly poor in terms of skills development among people in the locality. That is not just for the local authority to address; it is for the Department for Work and Pensions, economic development organisations, etc. A number of agencies in the locality have presumably started to address that. What will be the impetus for that in the future? Who will be saying that skills are an issue in Rochdale in the future, or whatever it might be? How will that be flagged up in future?

**Professor Martin:** I fear that that is almost a rhetorical question because the answer is that I do not know—I do not know whether my colleagues do. I fear that there will not be the same impetus. I know the Rochdale example and that they were very upset to be given that red flag. They argued with some justification that the problem of worklessness was not unique to your borough and that they were doing everything they could to address the problem. Nevertheless, I think that awarding a red flag focused attention on it. It required them to ask questions of themselves and to give an account in the local media about what they were doing. Therefore, fair or unfair, the red flag provoked a discussion and debate, and redoubled attempts to deal with that issue. I simply do not see what will provide that in the future.

**Q48 Mark Pawsey:** One of the roles in which the Audit Commission was involved was to provide national reports, including studies on value for money.
In the present economic climate, it is more important than ever that we get value for money out of our local authorities. With the demise of the Audit Commission, how will that role be taken up? Will the independent auditors we have spoken about be capable of carrying on that work? Are they likely to want to do that work as part of their role? Where does that go from now on?

**Professor Heald:** That raises a number of issues. Obviously, the private sector auditors within the existing system are carrying out value-for-money works specified by the Audit Commission for which the commission is taking the legal and liability risks. The private sector auditors might be willing to do value-for-money work, if they are commissioned by some national regulatory body.

**Q49 Mark Pawsey:** Which national body is likely to do that?

**Professor Heald:** That comes back to the fundamental question I raised before about whether Parliament is going to address the whole structure of public audit. If one decides not to address the structure of public audit, I suspect that one needs some kind of residual Audit Commission with a regulatory function. I am deeply sceptical about the proposed scattering of the different functions across a range of bodies. It is not at all obvious to me, given the differences between public and private audit that I emphasised before and the general lack of interest of most of the accountancy institutes in the public sector, that those registration bodies are the appropriate vehicle. Private sector firms will do what they are paid to do. What I worry about is that you get the collapse of the nationally comparable value-for-money studies and a plethora of cheerleading reports about how wonderful whichever authority one is talking about is but without a solid database. That would create reputational damage for the sector and not help the National Audit Office.

I think there is a suggestion in the evidence to this Committee by the Department for Communities and Local Government that the National Audit Office can step in, but the National Audit Office’s value-for-money work in areas such as health and education was solidly underpinned by the work done by the Audit Commission. That underpinning has been taken away, so there is a broader question about the role of the National Audit Office and, if it is not the National Audit Office, whether the body that takes the regulatory role from the Audit Commission has sufficient powers and competence to satisfy the Comptroller and Auditor General.

**Q50 Mark Pawsey:** But would not an advantage be that there would be a value-for-money comparison between public and private sector in a way that does not exist now?

**Professor Heald:** It depends on what we mean by value for money. I interpreted it as meaning value for money for council services. The audit bodies that contract out part of their work make assessments about the value for money of the audit provision by their own in-house provider and by the private provider, but that is a narrower question.

**Q51 Mark Pawsey:** But there would be data available to compare the value for money of services within local authorities and other external bodies if we had the big four carrying out audit, for example. Do you not see that as an advantage?

**Professor Heald:** If one is talking about value for money from local authority services, because one has large numbers of local authorities, the key question is whether one can do studies at a sectoral level to get comparisons, because one probably learns as much from the comparison between authorities as one does by looking at individual authorities. Therefore, the question becomes: who is to commission and pay for that work? That is quite different from a value-for-money study undertaken by the auditor for a client local authority. As I think I mentioned earlier, one of the other issues that will come up is the question of non-audit services, because that has been very strongly policed in the local authority sector by the Audit Commission.

**David Walker:** It is worth observing that, historically, it was never clear where NAO and Audit Commission value-for-money studies began and ended. The NAO did Sure Start, which arguably follows money into local space, and the Audit Commission sometimes did studies that seemed as if they were looking at Whitehall. Often the best work—for example a fantastic study about obesity in children—was a joint effort by the two bodies. In future, as long as the expertise is captured, it is not really terribly important who does it, but the NAO, accepting David’s misgivings about overloading that organisation, surely would be the receptacle for national studies.

**Q52 Stephen Gilbert:** How will Ministers here be able to see what impact their policies have on local government across the country?

**David Walker:** Again, that is a way of rephrasing the question that has been before us this afternoon: do we believe that local authorities have autonomous capacity to tax, spend and do policy, or do we believe that they are necessarily to some extent agents of central Government—of this institution, the House of Commons, and of the Executive? If we believe the latter, clearly the Government need an apparatus of inspection and to some extent performance management, but we are here today because this Government decided that they wanted to get rid of that apparatus for performance management. Therefore, in a sense, your question has already been answered to the extent that the Government no longer want to have—correct me if I am wrong—such a capacity to follow through policy. It believes that is a matter for local adjudication.

**Professor Martin:** In part, the question owes something to the written evidence I submitted. While I agree with David, presumably you will want to hold Ministers to account for the decisions they have made, so the question becomes not necessarily whether local Government has improved as a result of these decisions, but whether there is evidence that the particular decisions we have been talking about today were justified over time. I am afraid that I raise the question but I do not have the answer. I raise it because I think it is an important one. We had plenty
of information about the impacts of its policies, which was not always very well used by the previous Government. It seems to me that we are now in danger of swinging to the other extreme and having no idea in three or four years’ time whether or not the kinds of concerns that you have been raising with us today are valid.

Q53 Stephen Gilbert: And that would weaken Parliament’s ability to hold Ministers in CLG to account.

Professor Martin: I just do not see how you will be able to do that. We will be descending to the level of discussions about spending on pot plants, days at the races and that sort of thing. We will be reliant on anecdote from here and there, and perhaps these cheerleading reports to which David alluded. There will not be the firm evidence base that you would need to ask intelligent questions of Ministers.

Professor Heald: Projecting forward three or four years, one of the things one might know is whether there are significant service and authority failures. The other thing would be what happens to audit fees and whether one gets the narrowing of the scope of public audit that I talked about before. What worries me is that there is a kind of withdrawal of central Government from data collection, which might be useful for a time, in terms of being able to deflect blame and say it is nothing to do with them, but it would also tend to mean that the early-warning systems about where problems lie might fail. Therefore, one of the things in three or four years’ time might be the fear of a much more sudden failure. Some of the people giving evidence to you just do not think that financial resiliency is something that should be included within the remit of the audit. I notice that the Department does not take that view, but one thing that the Audit Commission system did was to signal weak performance. Research I have done myself shows that you can see the way in which there were changes of management teams in poor-performing authorities. You can see people moving from well-performing to weak-performing authorities. That background evidence of where people are will not be there, so the shocks will come.

Q54 Chair: Finally, I would like a brief response from each of you. In light of our general discussion, would reform have been a better option than abolition as far as the Audit Commission is concerned?

Professor Heald: Yes, but the significant point is that one had to think about what that reform should be. I have been deeply concerned by the way in which the changing legal status of the National Audit Office has been dealt with by Parliament. I very much worry that when the Government want something done in a hurry, it is remarkably easy to get it through Parliament, but not with respect to things that refer to the management of Parliament and Parliament’s housekeeping—we see that expenses have done reputational damage to Parliament, and failures about public money could do reputational damage to Parliament. Therefore, I would have liked to see debate of the kind we have been having this afternoon about the scope of audit and who should do it. I think we have now reached the point where that debate has to take place. I think the sensible thing to do would be for the Government to withdraw the national audit provision in the Budget Responsibility and National Audit Bill, which is presently stuck in the Lords, and have a full public audit Bill that deals with the whole thing, probably preceded by a proper Green Paper or White Paper.

Professor Martin: In terms of the assessment and inspection side, I would argue for an evidence-based assessment of the options. Therefore, one should not have prejudged whether it was reform or abolition, but taken a sensible look at the alternatives before leaping to the conclusion reached in August.

David Walker: With the proviso that of course no public body has a right to permanent existence, there were all kinds of ways in which—given the relationship between centre of the commission and the district audit service as was and the audit practice as it is now—cleansing and cheapening could have been effected and a number of the problems with which the Government are now confronted and which we have explored in part today could have been avoided.

Chair: Thank you all very much indeed for your evidence. It was very interesting.
Monday 7 March 2011

Members present:
George Hollingbery (in the Chair)
Heidi Alexander
Bob Blackman
Simon Danczuk
Mike Freer
David Heyes
James Morris
Mark Pawsey
Steve Rotheram

Examination of Witnesses

Witnesses: Peter Holland, President, Chief Fire Officers Association, Peter acey, Audit and Accounts Adviser, National Association of Local Councils, Councillor obert ight, Deputy Chairman, LG Group Executive, Local Government Association, and Councillor Jill Shortland, Vice-Chair, Local Government Association Improvement Board, gave evidence.

Q55 Chair: Good afternoon, ladies and gentlemen. I am George Hollingbery, temporary Chair of the Committee in Mr Betts’s absence. He is away today. Welcome, and thank you for coming. We are scheduled to finish at 10 minutes past 5 o’clock, and I shall try very hard to finish at that moment. If we start getting a little behind, I hope you will not mind if I jolly you along slightly. If you feel your question has been adequately answered by others, please do not feel obliged to put in your two penn’orth; we will happily take it as written that your opinion has been expressed.

Were the Government right to abolish the Audit Commission? Within that, contingent on your first answer—the evidence you have all submitted supports the idea that they were right to do so—was it how the Commission went about its business that upset those it audited, or was it the scope of what it was doing that was the problem?

Peter Holland: Everyone has its day. No one would disagree that the Audit Commission has provided a function over the years, but we are in 2011, and the question is: is that what we need in terms of local government for the future? We would argue very strongly that things have moved on from the late 1990s, when there was a strong need for that major audit function. The Audit Commission itself had moved into other, larger passages which were not necessarily in the remit of an audit.

We would take the view that the sector itself, using peers, skill bases and knowledge bases, is in a better position to provide those development and support mechanisms which the Audit Commission were branching out into. The narrow audit function, which we believe should be constrained to financial management, risk management and probity, does not need a national body. A free market option could provide not just a better but a more cost-effective audit function.

Q56 Chair: Did it feel like central Government were reaching down through the Audit Commission to control what you were doing, or was it just that it was overly burdensome?

Peter Holland: I think a bit of both. It was definitely overly burdensome for local authorities, and the work that local authorities had to put in for every piece of the audit and inspection was just horrendous, as was the number of people that involved. It was more the diversion from where you wanted to go, because you were going to be inspected or audited, that was the case.

Especially in the latter years, some of the increase in performance indicators was definitely Government reaching down and interfering with local government rather than supporting us and helping us. I think that’s where the Local Government Association and the sector are saying that we want to have the support work done for ourselves. We can do that element of the work. We understand that there is still a need for audits for financial, probity, regulatory work and governance issues, and there is still a need for some inspection, for example, with regard to the safeguarding of children and adults. But we have so many tools now within the sector that we believe we can support local authorities, and local authorities will reach out to be supported far more with the tools that we now have in place. We have got some packs available to all of you that can give you some information about that huge level of support that we have in place.

Q57 Chair: If both councillors can answer quickly, did either of the authorities on which you sit ever change what they did because of an inspection by the Audit Commission?

Peter Holland: Yes, I think we did. We got criticised as part of our first CAA inspection process for our locality committees and how they worked. It was very popular with the people, but the Audit Commission said, “Because it’s not uniform, it’s wrong.” So the council changed it on the recommendation of the Audit Commission, and our local people are very unhappy about it.

Q58 Chair: Mr Holland?

Peter Holland: On the same question?
Chair: No, just generally about whether it was right to get rid of the Audit Commission. How do you and your members feel about it?

Peter Holland: From the fire and rescue services’ point of view, the work of the Audit Commission as the transformation of the fire service took place post the industrial disputes of 2002–03 made a significant difference to helping us change, modernise and improve the service, to the point where half the number of people are dying and being injured in fires and the number of fires is going down. The Audit Commission absolutely had a part to play in that. The problem that we have encountered in the last few years is that it was almost like we were feeding the beast of the Audit Commission rather than necessarily getting on and delivering the services. There was perhaps too much emphasis on the audit side once we had got our organisational act together to drive the service forward.

Q59 Chair: Was it an arm of Government, or was it just overly intrusive? Did it generate its own intrusion?

Peter Holland: It generated its own intrusion. The other issue for the fire and rescue service, which is significantly different from other parts, is that we do not have an inspectorate. When the inspectorate that was within CLG and ODPM—and the Home Office prior to that—went, that role went to the Audit Commission. There are issues for us about what happens when something goes wrong. When there is a serious issue in the fire and rescue service, who is going to inspect it on behalf of the Government? Who is going to intervene? We need some clarity on where that is going to come from.

Q60 Chair: What about the behemoth of the Audit Commission with smaller councils?

Peter a e : Yes, the bulk of the clients but the lowest value; that is our particular problem. The difficulties for the Audit Commission came 10 years ago, when a lot of councils in my sector were complaining about the cost and quality of external audit, so they changed the rules to this new negative assurance, which has been running for 10 years. Quite honestly, at the moment everybody is happy. Don’t change it. We are therefore looking for how to make things proportionate—how to carry things forward that are proportionate to the rest of local government—and proper, looking at probity and governance issues, but still not raising the cost so that we are spending £5 to inspect expenditure of £10.

Q61 Chair: But your members have been carried somewhat by the expenditure of larger arms of Government over the years, have they not?

Peter a e : I don’t think so. I cannot see that the levels of “subsidy” for other levels of authorities have been that significant. In some areas, occasionally there have been substantial grants to county associations and things like that, but generally for the sector it is not that significant.

Q62 Mark Pawsey: We are moving to a system where the audited body seeks its own auditor, but it is a fundamental principle that the auditor is independent of the authority being audited. May I ask each of you how that independence will be safeguarded if the body chooses the auditor?

Q63 Mark Pawsey: But is it right for a council to select an auditor? Would it not be better for the auditor to be appointed by someone independent?

Peter a e : I think there is an over-egging of independence. What happened before? The council’s auditor was appointed by the Audit Commission, but that didn’t mean to say that you got someone who was good and who knew what they were doing. It didn’t mean that at all. It meant that the Audit Commission thought that they were somebody who could do the job. I have had experience of both. If councils view the role of the auditor—as I think 99% of councils do—as that of a constructive partner who is there to help the process but who can be a critical friend and sometimes give tough love if necessary, then I don’t see any conflict in the council appointing an auditor.

Q64 Mark Pawsey: So there would be no chance of a local authority selecting the auditor that might look most favourably on the task?

Peter a e : I cannot see that any auditors that have made their way on to a national list through having professional qualifications would give any bias to a local authority or to any of their clients. I would think that they would be more likely to make sure that they do the right job that they are employed to do. It is quite important for councils to have freedom of choice. Councils should be able to pull together to select auditors that could then circulate between them every so many years, because they will get a more cost-effective process that way. Where you have multiple tiers of authorities—counties, districts, parish and town councils—we should have the ability to appoint a group of auditors that can work for the whole tier sector in that area. It is important that councils have that freedom, but within a national
framework of regulation that is usually the professional bodies that they belong to.

Q65 Simon Danczuk: I have a supplementary question about Councillor Light’s point about the idea that competition will generate independence. Just because auditors may compete with each other to try and win the work of a local authority, surely that does not suggest that they will be more independent in any way. The reality—I think Councillor Shortland highlighted this—is that in the example of private companies choosing accountants, they choose those with whom they will have the most comfortable relationship. Is there not a danger that the same will apply in local government? I haven’t heard anything that assures me that independence is assured from the new processes that are being proposed.

Q66 Mark Pawsey: How would fire and rescue authorities safeguard the independence of the auditor if they were selecting that auditor?

Peter Holland: Currently, as I am sure you are aware, 70% of the audits done on the fire and rescue service are done by the Audit Commission; 30% are already done by the private sector but they are appointed by the Audit Commission. Each fire and rescue authority has a separate audit committee. The people on that committee are fairly controlled—they would not sit on the finance committee, for example—so there is a degree of separation there. But accepting the points that colleagues have made, if you want transparency in that selection process, and accepting that you have a panel to choose people from, it would be possible to have an independent person chairing that audit committee. Just a thought. I understand your concerns. The obvious thing is to ensure that people are auditing to the same standards across the piece and are working off objective evidence.

Q67 Mark Pawsey: Mr Lacey, I have a specific question about smaller councils—parish councils and town councils. How would they have the level of expertise to be able to select an auditor and ensure that that auditor would be independent?

Peter a e : I am not sure that on their own they will. This is one of the pretty difficult questions that the proposal to abolish the Commission brings out. For some bodies—I think the smaller bodies, where we have 9,000 of them—the selection of their own auditor will be very difficult, if not impossible. Currently, the Audit Commission selects on a county-by-county basis; it is a block contract. I suggest that that sort of model has got to continue, and we need to find a way of working it together, perhaps with the county council—I don’t know, some way of working it together. Each parish council is going to find this extremely difficult, if not impossible, to do properly. Procurement is an important thing to do right, and I fear that it may not be done right.

Q68 Mike Freer: I have a quick question for Councillor Light and Councillor Shortland. Could you confirm that, irrespective of the auditor and who appoints them, the section 151 officer has a statutory duty to the accounts, whatever the auditors say or whoever appoints them? That is an additional safeguard that many people outside local government do not have.

Q69 Mike Freer: It might be helpful, Chairman, if we had some submissions from the LGA on the role of the section 151 officer.

Q70 Chair: Presumably, there is nothing to stop an LEP, or a structure to which various councils have ceded authority, having a joint committee at that level, which appoints a random set of auditors across local authorities. I cannot imagine that there is anything that will stop anyone doing that.

Q71 Chair: Moving on, the evidence submitted is pretty unequivocal. You have said this afternoon that the Audit Commission went too far. You are pretty comfortable, I think, with financial audits and probity audits and so on and so forth. Where does that stop? Let’s ask the councillors first. What is it that audits should be doing? Is it value for money? Is it any other business or is it just finance and probity?

ill ortland: That is exactly what we were talking about earlier. It is important that local authorities have the freedom to work in that cross-border way. In my local authority area, the county and the districts already have a joint internal audit group. All the officers work together on audit. It is an audit team locally anyway, so we would not want a situation where they had to go back to appointing an individual per local authority. It is not cost-effective or sensible to do that.
there is an argument and a discussion still to be had. The experience we have had on the value-for-money aspect of auditors has been varied across the sector. Some auditors have been co-operative and helpful. They understand the business and have been very constructive about advising councils and giving information about value for money. Some of the value-for-money studies that have been done have been very good. Then we have others that are not the same case and they have been pretty poor. The auditors who have been in have been subjective and have not really understood the business and have strayed over into the political remit of the authority. From my own personal position—I think some of the LGA support this position but maybe not all—I would argue very strongly that value for money should be left to the sector, and the sector should be responsible and answerable to its communities. If you have a local authority that is not value for money and you have used the tools and the public have seen those tools, then the public have a right to vote you out.

Q72 Chair: What about the IDeA-type model that we had previously with other peers coming in and having a look at you? Does that model work? ill ortland: Yes. Do you want to talk about the peer group because that definitely works?

o ert i t: It does, and what we have is more than 10 years of experience of that actually working. When we have put together teams of peers to go into authorities that have been having problems, the performance has improved. The results are there across the country. It is fair to say that where peers have worked in authorities, the benefits have been clear in terms of any inspection or measurement methods used, and something like 70% of authorities have had peers working within them. The opportunity to develop the peer model as a way in which the sector supports itself is very strong—not just from councillors but from skilled officers who can put in expertise there, as well as outside business interests, and perhaps spreading that into health professionals working with that peer support team because that will be a growth area for local government in the future.

Q73 Chair: That is done by the LGA presumably? ill ortland: The improvement arm of the LGA. We have several pieces of work that we have done that have already been proven. We have done some work on customer insight, and on self-regulation and improvement. The sector is very supportive of the work that we are doing and our direction of travel. Government Departments are now supporting us as well. For example, the Department for Education is just agreeing with us a package to put in children’s service leads to join the peer teams to go out and support and challenge authorities. This is the sort of work about which the sector is saying, “This is more the sort of thing we want. We don’t want to be regulated. We want to be supported so that we can actually develop in the way our local communities want us to develop, rather than a set national model that perhaps is maybe appropriate for one area, but not for another.”

Q74 Chair: Mr Lacey, do we have a small companies exemption-type regime for small local councils?

Peter a e : Yes, effectively we do. Increasingly, we are now getting some quite large councils being formed—the likes of Shrewsbury and Salisbury. There will be an increasing interest in having peer group visits and that sort of thing, which are much less formal than is appropriate for the larger authorities.

Q75 Chair: My local parish council raised £2,000 in precept last year. Have you got an idea of where a threshold or cut-off would be at which you needed to be audited?

Peter a e : Some people will say that all public money should be audited, but there is the question of whether you spend £5 to audit £10. Therefore, there is a feeling that perhaps below £1,000 a year, it might be quite clear that you say, “No, there need not be an audit unless”—and the “unless” is an interesting point. So, where do you draw the line—at £5,000? Maybe. It is a grey issue. It is subjective to a certain extent, but all the way through we do have the issue of public interest and the objection question—the public money audit questions. We need to see where they are going to fit in the brave new world, and at the moment it is not clear. It is, like Jill has said, a debate to be had.

Q76 Chair: Mr Holland, it is a different world with the fire authorities.

Peter Holland: It is a very different world and, if I might say so, the fire and rescue service, in conjunction with the LGA, has led the way in sector-led improvement and assessment. That model has been up and running now for well over a year, particularly focusing on the operational service delivery elements of our role, which, of course, is where it is difficult for somebody who is not a professional in that area to go along and audit. The huge benefits of using that peer review-type process is a two-way thing. If I—and I do—let my officers go out and do audits of other services, they will come back with little nuggets that they have picked up from their audits, as well as helping colleagues in other services. If you want to have a more detailed look at what we do, I am very happy to share that with you. I know we have sent you a document with that information in, but I can assure you that that has been incredibly well received by the service.

Chair: Tremendous. We have 25 minutes left and seven questions, just to give us all a benchmark.

Q77 Simon Danczuk: We have talked briefly about audit fees. In this brave new world of audit, will it be cheaper for local authorities to commission auditors?

o ert i t: It is very dangerous to say yes to that.
pay it”. It would never justify the increase in fees. It would just say, “That’s what it costs, so you have got to have it.” Bringing in competition will be healthy and, in the long run, will actually see fees level out at a more acceptable percentage.

**ill ortland**: I agree.

**Chair**: The evidence is very sketchy. We heard a month ago that in Australia the numbers had gone up.

**Q79 Simon Danczuk**: Yes, the cost went up. But I’m sure the National Association of Local Councils has a view on cost and fees.

**Peter a e**: Of course, we have the particular problem that the smallest 1,200 councils don’t pay an audit fee but still get an audit, so trying to find savings and costs for them is—shall we say—challenging. Audit cost is seen as an issue. At present, it is not the major issue that it has been in the past. We have the benefit, of course, that we have a five or six-year contract where the fee bands are fixed for that period. Councils are able to say, “We have a turnover of £50,000, so our audit will cost so much,” and they know what is coming, unless there are problems. That seems to work. A six-year contract for professional fees is unusual, but it has worked for us.

**Peter Holland**: If I might come in, we pay significant amounts at the moment—around £70,000 a year. Using the peer review process, of course, you’re already employing those staff, so your costs are almost inevitably going to come down fairly significantly.

**Q80 Mike Freer**: I want to ask about the requirement to publish information on all expenditure over £500. What’s your experience so far? Is that driving down costs and spending?

**o ert i t**: It is too early to say at this stage. I think it will mean that authorities are a little more cautious in terms of what they do, which can only be a good thing, but we’ll probably need a few more months to evidence any change.

**ill ortland**: Councils have not been hiding these things in the past. A lot of councils have published and been happy to publish information in any event. If people have asked questions at audit time, they’ve opened their books and shown them, so I don’t think it’s going to make a vast difference in the very short term. As Robert said, it will be more a case of the more that goes on, the more councillors will probably be thinking twice before taking decisions.

**Peter Holland**: I used the term “nuggets”, didn’t I? On the question of sharing best practice, everybody at the moment is looking for those little nuggets that are going to save them significant amounts of money by allowing them to deliver the same level of service at lower cost. When you’re doing your work, those are exactly the things that you’re looking for and, indeed, that we’ve found as we have been carrying out our work.

**Peter a e**: One of the issues for us is that the original announcement referred to local authorities. When you’re a parish council, you always have to stop and think, “Does that mean us or not?” What is the definition of local authorities? For some purposes it includes, but for some purposes it excludes. It’s now clear in the consultation paper that it is expected to include parish councils and parish meetings. That will present some with quite a problem; for others, it will be no issue at all. For the very small, where there may not be a website and there might be a clerk who is elderly and not trained in computers, it’s going to be quite a headache, but for the Shrewsburys and Salisburys of this world, it will be no problem at all. We have to a certain extent already led the field, in that our minutes of parish councils have been pinned up on the notice board and circulated for many years. Those have included lists of cheques drawn, so the detail has been there for many years. It has not been in every case, and not as a requirement under a code, but the principle has been followed.

**Q81 Mike Freer**: If there’s a broad welcome for publication, is it right that a resident’s right to challenge the accounts should be swept away?

**o ert i t**: No. The resident should always have the right. An important part of localism is taking it beyond the council to the people of the borough. All bodies should encourage opportunities for public scrutiny, and that will be part of it.

**ill ortland**: I agree.

**Peter Holland**: Where things do need to improve is in terms of the clarity of information that goes to the public. Anybody opening up financial reports on most authorities would probably find a cure for insomnia, rather than finding out exactly what is going on. That’s where things need to improve.

**Peter a e**: I think we, as the parishes, may have a disproportionate number of the objections and questions—they are certainly disproportionate in value. On some occasions, the questions are clearly vexatious, trivial and frivolous, and something needs to be done because it ends up costing the poor parish because one person has raised a question that is probably the result of a personal vendetta—these things happen. But the principle that an elector should be able to object and question something has to be there. It’s another of these very difficult issues. How do you avoid spending £5 to check up on £10 and yet produce the ability for someone to say, “That’s wrong”? We can all select examples and say, “That’s a frivolous question. Don’t bother,” and then the next-door parish says, “Oh, that’s interesting,” and sure enough, six months later, the fraud squad moves in because of something that was asked. It happens. It might not happen very often—once a year, once in six years or whatever—but it happens. It’s going to be a difficult issue for legislators to address.

**Q82 Chair**: But on the whole there’s general agreement that there should be a right to challenge of some sort?

**Peter a e**: There’s going to be something.

**Q83 David Heyes**: It’s quite clear from the written evidence submitted by the LGA to the Committee that the Local Government Group has done a fair amount of work already on developing a new approach to self-regulation and improvement. If we no longer have centrally imposed targets and rigorous external inspection, which some would argue the Audit...
Commission provided, what is there to stop local authorities coasting in future?

ill ortland: I don’t think it has just been inspection, regulation and targets that have made local authorities want to improve. Every local authority that I have come across, bar maybe about three, has wanted to improve because they want to make things better for their communities. At the end of the day, if you don’t improve the services, how do you get yourselves re-elected? That has to be the first question.

Most local authorities want to improve in any event, and I think that the days have gone of people sitting and coasting because, apart from anything else, you can’t afford to do that. You need to look at different ways of doing things and improve the way you do things in order to keep costs down, especially in some of the services where most of the costs are in staffing. You have got to find new ways of working and new deliveries to be able to improve the services that you are giving to your clientele, and the public get more and more demanding, so of course you have to continue to improve.

I don’t believe for one moment that local authorities will just want to stagnate. The responses that we have had to self-regulation have certainly said nothing about stagnation; they have been about wanting to have support to be able to move their authority forward. Local authorities still want to pitch against their neighbouring authorities. They still want to look to provide better services than their neighbours, so I think that that determination will still be there.

Q84 David Heyes: I want to hear what your colleagues have to say, but you said “bar three”, and that was under the existing, rigorous statutory regime. We are now moving to a much lighter-touch, voluntary arrangement self-regulation. Is that “bar three” going to become “bar plenty”? What safeguards are there in the work that the Local Government Group is building to ensure that that doesn’t happen?

ill ortland: I don’t think the safeguards were there under the present system, otherwise those three would not have done the things that they did and would not have allowed things to slide. I don’t need to name the cases where the inspection regime went in and they came out with good results yet children still died. At the end of the day, you are not ever going to prevent that completely, but if you have a sector whose role is much more willing, open and supportive, people are much more willing to come forward and be supported to improve. At the end of the day, if a local authority doesn’t want to do that, let the electorate take the action they need to take.

o r t i t: The issue is that, if Government, the LGA or anybody thinks that they can design a regulation system whereby there won’t be some failure, that is naivety gone mad. There will always be someone, no matter what system, where it is a question of how you deal with them, how you detect them and how you intervene before the wheels drop off. The method that we have been developing at the LGA is to deploy the intelligence of skilled professionals and skilled political operators working in the field so they know when things are not going right so help can be put in there. I will give you one example from personal experience when I was leader of Kirklees council, which for me typifies the importance of support, rather than targets and inspection, in terms of ensuring that services are right. We all know about the baby P situation in Haringey. At the same time that that was in the media, so was the case of Shannon Matthews in my authority. I had a situation where my authority had been rated by Ofsted as good at safeguarding for children’s services, just like Haringey. I also had a situation where I had the Ofsted people crawling over it, saying, “Everything’s okay,” but, as a leader, how did I know? I knew what had happened—they said exactly the same about Haringey and what had happened—but how did I know that my authority was right and that things were going on? Let me tell you how I found out—I got peers in to look who weren’t on an inspection mantra or looking at targets. They were looking at outputs and outcomes. That’s how I got the assurance that my authority wasn’t in a mess, that we were doing the right thing, and that it had just been a bad case that had hit us.

For me, that is a crucial factor in terms of what we are trying to do here. We are trying to have a situation where we make sure we get away from targets, and get towards actually delivering outcomes and assurance for everybody who is doing that.

Q85 David Heyes: You make a strong case, but what’s to stop some local authorities or fire and rescue services from simply opting out of this new voluntary arrangement?

Peter Holland: It is a voluntary arrangement, so people could opt out, but then it would be a question for the Minister to make a judgment on whether to consider some intervention to check why that service or authority was opting out, and whether it was looking to hide something.

You were making a point about coasting. There is a real concern that people could and would coast, but part of the sector-led peer review approach has been to identify some clear agreed performance indicators, which you can benchmark across, so an elected member on a fire authority or a member of the public could look and see how Blogshire fire services compare against shire fire services to see what the issues are, and then ask some pertinent questions as to why that should be the case. The key is to have the framework in place in the first instance that can be altered against.

Q86 David Heyes: Is there a brief answer to the question about what the likely cost of these new arrangements will be, particularly in comparison with previous costs with the Audit Commission?

ill ortland: The peer review and the improvement agenda have been costed out and we have that in our budgets for next year. The sectors are paying for that themselves, as well as the top slice that we get, and we have obviously slimmed down our structures completely, but we’re actually combining our work. Instead of it just being local government now, we’re working with Government Departments and we’re
working with the private sector, bringing in peers from businesses as well as from health and other bodies, so we’re actually making a better offer to local authorities than ever we’ve made before for less money.

Q87 David Heyes: Can you quantify less?

ill ortland: I can get you the figures, yes.

Q88 David Heyes: I think the Committee would be interested to receive them.

Chair: To be clear, it is not subscription-based and you get this for a number of weeks’ inspections every five years. This is something you would pay for as a member of the LGA and be qualified to pay for because you are a member. Is that what you’re saying?

ill ortland: Yes. All members of the LGA and everybody who is part of the LGA get one peer review every three years. If they work together as a group of authorities, they can get more than one peer review each year, and there is flexibility about that. The way that peer review used to work was that pretty much all of it was designed by local government—the RDA. The way that the new system will work is that part of it will be designed by the local government group, and the other part designed by the authority.

Chair: We will look at the details when they come up, but basically—nterr ti n I am sorry to rush you.

ill ortland: That’s okay.

Q89 James Morris: I just want to probe a little bit more about situations when we have serious service failure, particularly in relation to children and vulnerable adults. I hear what you are saying about peer review, but isn’t part of the function of inspection the protection of the public interest? The question that then arises is who decides whether a particular authority is acting or not acting in the public interest in relation to a children’s services issue. Are you confident that if we move to this peer review system, who will make those decisions and who will make those recommendations, and does it come back to a Minister deciding? What kind of safeguards will be in place to make sure that the public interest is protected, and that the public do not feel as though peer review might mean collusion among the sector?

ill ortland: In terms of vulnerable children and vulnerable adults, it is very clear that Ofsted will continue to play its role in terms of vulnerable children, and there will still be the independent inspection for vulnerable adults as well. That will not change as part of this. All that used to happen is that it used to feed into the work done by the Audit Commission in the past. That won’t change in terms of the procedure. What I do hope will change—is that we’ve seen the evidence of this—is that these bodies will become more adept at what they do. As I explained earlier, from my personal experience I was not convinced that Ofsted was right, and as a local politician, I wanted assurance from people who understood things on the ground in terms of peers. I think that distinct example shows how both are needed.

In terms of the other public interest areas where the public have a right to be concerned, I think the issue will carry on. In terms of financial audits, if there is a problem on that side of things that will be picked up through the audit process. I don’t think that the demise of the Audit Commission would change that. If you look at other areas, clearly the way that the sector handles them will be an important thing and it is about knowing what is happening in the different areas of the country and also about knowing what “good” looks like and what “failure” looks like. For too long, those who have been conducting the safeguarding might have known what “failure” looks like in the books but they have not always known what “failure” looks like on the ground.

ill ortland: Can I add that part of what we anticipate the auditors and the inspectors will do, because they are working with that authority, is to set a programme up? At the moment, when auditors go in a work programme is set up based on what the auditors have said. You have the audit list and then you have the actions that the council will deliver and the time scale within which they will deliver those actions, to make improvements on what the auditors have commented on. We hope that the auditors and the inspectors will do exactly the same thing and the council leader will then talk to the sector, the regional advisers and the peer leads and say, "It’s clear from my last audit that I’ve got some improvement work required in this area. I think I will need a peer team in to deal with that!", or, "It’s clear that we as a collection of authorities in this area have got some issues, because of lack of recruitment or whatever reason, and we need some help and support to deal with them”.

Q90 James Morris: In your new model, who ultimately will have the power to authorise an intervention? I understand where you are coming from. It could be argued that more of a peer-review system might avoid some of the situations that you were describing, whereby we have had inspections that have given good results but they have not identified the underlying problem. But where will the actual power reside within the structure that you are describing?

ill ortland: There will still be power with Ministers on the issue of safeguarding. Inspections will still continue and if an authority is inspected and found to be seriously wanting, there will still be powers of intervention. However, judging from the work that we have done so far with the DfE, it looks like we are moving towards a different situation. Rather than having an immediate intervention—obviously, if there are serious issues you would need to have an immediate intervention—if an amber flag is starting to rise, the DfE would work with the LGA group to start some of that intervention work, as peer-challenge work rather than peer-support work. So there will be a much more robust series of discussions with the council leader, through the inspection team and ultimately through the regional peers and the support team that is in there working with the council. We do not want to get to a situation where the Local Government Group is seen as the hand of central
Government, but we do want to get to a situation where the sector is looking after itself. We already have lots of ways of intervening with local authorities that I would rather not share in public, but councillors make sure that those councils that are starting to slide have some support.

Q91 James Morris: Why would you not want to share them with the public?
ill ortland: It’s political.

Q92 Chair: Can we get a submission? I do not know if we are capable of keeping something confidential, but we would love to see that.
ill ortland: I am quite happy, and I think that we would all be quite happy, to talk about the political intervention that takes place in the performance panels that we have.
Peter a e: May I briefly add that Local Government Improvement and Development receives top-slicing and support for all its development work, whereas the parish councils associations receive nothing?
Chair: So noted.

Q93 Simon Danczuk: I wanted to ask about the voluntary scheme and ask if it really works. There is this idea of peer review. I have listened to your contributions throughout the evidence-giving session. I have heard about peer challenge, peer support, peer leads. I am familiar with peer review, having been an elected member myself, but it doesn’t have any public connection. It doesn’t really speak to the people, not like the comprehensive area assessment, place survey results or things like that did. It might involve speaking to some stakeholders and things like that, but the public in a locality do not really pick up on it.
You talked about chief executives or senior management all wanting to improve, all being keen to identify what their failings are as a local authority and all wanting to share them publicly, but I don’t recognise that in some aspects of local government. I do not believe that that is the case. The reality, is it not, is that there is no real evidence that a voluntary scheme of the kind proposed will have the teeth and not, is that there is no real evidence that a voluntary scheme and ask if it really works.
Q94 Simon Danczuk: On that, is that not an argument to have both things, peer review and some national indicators which your performance can be judged by?
ill ortland: But the national indicators aren’t consistent, and that is the issue. If you have local indicators, which mean something to your local communities, that is a good thing—local councils that are switched on do have local indicators. But with national indicators, one indicator can mean something quite different in Westminster from what it does in rural Somerset. How you deliver services will not always comply with a national target—I can give some examples if you really want me to. Certain things do not happen the same way in a unitary authority as they do in a tier 2 authority.

Q95 Simon Danczuk: So you shouldn’t measure them at all—that is what you are saying.
ill ortland: No, what I am saying is that the measurement should be about the outcomes for individual people, not how the Government have been measuring, saying, “This is the indicator we want delivered”, which is more about process and measuring to a target than it is about people.
Chair: Quickly, it seems to me that there are political decisions reflected in the cost of something, for example. My local authority, which I sit on for a long time, Winchester, had very high amounts of money spent per planning application, because there were very large numbers of conservation areas and very large numbers of old buildings and, therefore, you needed many more specialists. National indicators, in my experience, have not done a great job with that sort of political decision—lots of money was spent on that angle, because it needed to be and because we had to do that.
I agree that the data set out there is very complex.
ill ortland: And the eight-week target is a really good example—eight weeks to turn over a planning application, so you get a poor decision or a refusal. Whereas local authorities that took a bit more time and were a bit more careful about their planning applications, consulting their parishes, were penalised under the national target. That is nonsense.
Q96 Chair: So you shouldn’t measure it?
ill ortland: I disagree—
ill ortland: May I be clear about one thing? I didn’t say chief executives and senior management. I spoke of local authority leaders and senior members, because they are the people who have to face elections every four years and who want to see improvement. I would argue quite strongly that in some cases the senior management and the chief executives have been the people who have been holding councils back.
We have seen evidence of that.
Robert will speak a bit more about the peer work he has done, but with over 70% of the peer challenges that took place, the councils improved and their scores went up. When we had the old CAA, there is real, strong evidence that, where councils had a peer review before going through a CAA process, they actually had a much better idea of their own self-awareness and the improvement needed before the CAA ever came about.

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important. The trouble is, if you look at how the last set was streamlined, it wasn’t about what matters, it was about each Department getting in and making sure that it had its few in there and was not cut out.

Q96 Simon Danczuk: So a voluntary scheme will work, it will improve? That was the question.
  o ert i t: Yes.
  ill orland: Yes.

Q97 Simon Danczuk: And there is evidence for that.
  o ert i t: Yes.
  ill orland: Yes.

Q98 Mark Pawsey: A system of individual audits and peer review means that there is no one pulling all this information together. One of the tasks of the Audit Commission was to issue value-for-money reports. Was there some value in those? Should the Government consider the Audit Commission continuing to carry out that function? Or was it of no value at all?
  o ert i t: It depends on what you see the function as. Arguably, similar things to the information that the Audit Commission published was very useful, but, actually, to whom? If you look at their readership, it was very limited. I think that the challenge for everyone is to ensure that the information made publicly available is made relevant.

Q99 Mark Pawsey: But is it not relevant to each individual authority, which can benchmark its performance against others?
  ill orland: Benchmarking one authority against another will be done in the future through the knowledge hub, where all the data will go. It will be a single database, and all the data that local authorities have to produce will go into it. They will be able to make comparisons on an apples-and-pears basis, not an apples-and-lesser basis, or was it before. The knowledge hub will have a moneysupermarket.com-type feel to it, and is well on the way to being developed. It will be launched later this year. Data will come in, and, within two years, that hub will be complete and fully serviceable.

The issue of local information and local value for money is about the local authority actually addressing value for money for its local residents, and that is a different set of criteria.

Q100 Mark Pawsey: So you would be happy to see that function of the Audit Commission go, along with everything else.
  ill orland: Yes.
  o ert i t: I think a good example of that would be that I could have some real fun comparing crime statistics and data with London boroughs, but it would not serve any purpose because it would not be a relevant comparison. That is what the Audit Commission does.

Q101 Mark Pawsey: Mr Holland, your organisation has been very critical of the Audit Commission’s value for money reports.

Peter Holland: The recent ones, yes. Bluntly, members of any authority, whether it be a fire authority or any other, want to know how their service is being delivered, so they need something to compare with. I absolutely accept the point about localism, but it is possible to look at similar sized areas and drill down to see why there are differences. Any chief executive should be held to account on the basis of comparisons. The important bit, of course, is getting indicators such that we are comparing not just apples and apples but Cox’s and Cox’s.

Q102 Mark Pawsey: How would you get a system of comparison between fire authorities if there is not somebody pulling the work together in the way that has been done before?

Peter Holland: We are doing that now. That is a long way down the line, actually, but because we are not multifunctional like other local authorities are, it is relatively straightforward. If you start by looking at fires and road traffic collision statistics and work around the outcomes from them, as tragic as they are, at least you have something quite clear to measure. It is then a question of pro rata to size of population, and you would want to know why in a leafy suburb of Surrey there are many fewer fires than in urban areas. It is fairly obvious to most people—social deprivation is a key part of that, of course, but I am sure you know that. You would need to drill down to find out exactly what is going on there.

Q103 Mark Pawsey: Mr Lacey, what are the implications for the councils that you represent?

Peter a e : Very few get involved in any detailed value-for-money benchmarking and comparisons at all. The difficulty we have is that each parish council claims to be unique. You immediately recognise that, obviously, as each constituency is, perhaps, unique.

Q104 Chair: A final question to all four of you, and I would like the answer ‘right’ or ‘reform’, please. Was it right to get rid of the Audit Commission, or should it have just been reformed?
  o ert i t: It was right to get rid of it.
  ill orland: It was right to get rid of it.

Peter Holland: I think it could have been reformed. It has not actually gone yet, has it? It will be some time before it is finally gone, so it could still end up being reformed, couldn’t it? The amount of burden it was putting on us certainly needs to be reduced—that’s for sure.

Peter a e : As far as we are concerned, the reform happened perhaps 10 years ago. The risk is that we are in a baby and bath water situation here. Certain things will have to change as a result of political decisions—there is no argument with that—but we have to make sure that we rescue the bits that need to be rescued.

One part that worries me, from the parish perspective, is having clear, central guidance for all the auditors, examiners, scrutineers—whatever they may be—so that they are looking in the same way at the same things wherever possible. Central guidance is important, and the Commission provided a lot of that
to the auditors and to those being audited. I fear we may lose that, and that would be a pity. It has worked. We have had the reform, and we are having some more reform. Is that necessarily a good thing or a bad thing? Let’s wait and see. We have to wait and see, as we are always the last in the list to be looked at, as I am today.

Chair: Many thanks to all of you for your comments. Thank you for giving us your time.

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**Examination of Witnesses**

Witnesses: Councillor Peter Fleming, Leader, Sevenoaks District Council, District Councils Network, Councillor Roger Phillips, Leader, Herefordshire Council, Member of Management Committee, County Councils Network, Councillor Sharon Taylor, Leader, Stevenage Borough Council, District Councils Network, and Councillor Dave Wilcox, Former Cabinet Member for External Affairs, Derbyshire County Council, Member of Management Committee, County Councils Network, gave evidence.

Q105 Chair: A very good afternoon. One or two of you have sat through the last session, for which I thank you. The remarks you made will be put in context now. We will plunge straight on and ask the following simple question: are the Government right context now. We will plunge straight on and ask the following simple question: are the Government right now. We will plunge straight on and ask the extent to which it assured a safety net for people they were probably right because the extent to which it ensured financial probity and extent to which it drove improvement through CPA, for which the Audit Commission was responsible, the sooner we allow it to float off, mutualise and do whatever it wants to do—so that people in the market, and no one can join it. I’m all to see how it can go wrong. There are now three companies to enter the market, the better. We only have to look at what happened with foundation trusts for a free market, and I think the Audit Commission is put in place to allow medium-sized companies to enter the market, the better. We only have to look at what happened with foundation trusts to see how it can go wrong. There are now three people in the market, and no one can join it. I’m all for a free market, and I think the Audit Commission should be allowed to float away and mutualise as quickly as possible.

Q108 Chair: In short, it was the way they went about doing. You are suggesting that that is now replicated somehow somewhere else?

Dave Wil o: No. I didn’t have a great problem with the scope. But the amount of data, the amount of bureaucracy and the amount of time that were being consumed were disproportionate to the outcomes. You needed to take significant action. Whether that was necessarily the most appropriate action, is open to question. But as long as you address those functional issues, you can move forward on that basis.

Q109 Mark Pawsey: It’s important that the auditors are independent. That was ensured previously by an auditor being appointed by the Audit Commission. In the new regime, local authorities and bodies will be able to select their own auditor. How can the public be reassured that they’re going to pick somebody who’s totally independent?

Peter le in: These are professionals. They are covered by a code of practice, much the same as if I
were running a company and I chose an auditor, solicitor or accountant. As long as we hit and are clear about the hoops that a company has to go through to be on that list, and as long as we make it not overly onerous, so that we have a proper free market around those that have been allowed to enter it, I don’t see any problem at all. I don’t see why councils should be treated any differently from companies in that regard. Of course we should be allowed to choose our auditor. That’s how we’re going to drive down costs and improve quality, surely.

Q110 Mark Pawsey: You spoke about a free market. In practical terms, how many firms are likely to have the skill and expertise to carry out these tasks? How much choice and competition will there be?

Peter le in: I think there will be a lot more choice than was given to you in your last session. The reality is that both Sharon and I have been using auditors outside the big four. At Sevenoaks, we’ve been using Baker Tilly. The fact is that we’ve been having senior partners—very experienced people—auditing us. If, as a small district, I had gone to one of the big four, I would have had trainees looking over my work. There’s an idea that small is bad and big is brilliant and brings a huge amount of expertise, but let’s not forget that local government is an adjunct to these big companies. This is not their main business. They decided to come into the market, but they don’t have huge amounts of experience in this market, and they are always looking across a number of sectors.

One of the exciting things about the Audit Commission being mutualised and floated off is that they do have experience in this market, along with health and housing associations. There is an opportunity for a number of smaller players to play a big part in the market.

Q111 Mark Pawsey: Councillors Phillips and Wilcox, your counties are bigger. Will you have the same breadth of choice?

o er P illi s: I would say so, yes. Obviously, when you come to the likes of the Kents and Essexes of this world, you’re talking big money and big services, so you have to represent that. I think you have to look at this in the context of the whole audit regime. You’ve got an internal audit and you’ve got your audit committee. I think it’s how the public perceive it anyway. If your auditor’s been appointed at your open council meeting, probably on the recommendation of your 151 officer and the public—once you find out about a 151 officer and their independence, like the monitoring officer, they are the two people you never fall out with in local government when you’re a councillor—when you see that in that context, then you have the whole mechanism there that gives you that level of confidence.

Dave Wil o: There’s an element of “suck it and see” in this. I don’t think we know in advance what the outcome of that is going to be. I’d expect us to be monitoring for churn. If there’s movement between auditors over a period of time, then I think that would be a healthy sign. I think we’ve got to start trying to identify how we can quality assure ourselves that the audit function is working effectively.

Q112 Mark Pawsey: Following on from that, would you support a compulsory rotation of auditors? Is there a danger that the auditor will become too cosy with the authority? Should the auditor be changed every five years? Would you favour that?

o er P illi s: That would be good practice. If it is not true, it is perception, and perception is sometimes more important than reality.

aron a lor: Can I just come in on the relationship between internal audit and external audit? That rotation is vital as far as I am concerned. So is the fact that the professional bodies for auditors, as I said before, have some kind of kitemark so that we can reassure the public that the auditors we’ve selected are guaranteed by those professional bodies. A lot of us in district councils have gone down the route of having shared service on internal audit. We’ve looked at the risks and the benefits, and there are considerable benefits around the resilience of the service and its independence. You can bring in people who are nothing to do with your authority to do the internal audit work on certain areas. You get a degree of specialism that you wouldn’t get because you couldn’t afford it in a district council and there are significant efficiencies.

I feel quite strongly that the same issues apply if you’re allowed to go to a different basket of external auditors. That’s vital to all of us. It’s not in any of our interests to have this job done poorly, because we have to account to the public and we need to be able to say to them, “The people who are auditing us understand absolutely what they’re doing and are independent in their judgments of us.” That’s vital to all of us.

Q113 Bob Blackman: Can I move you on to the scope of audits? The LGA and the CCN have been quite critical of the way in which the Audit Commission has looked at how money is spent. The CCN, in particular, has said that it is for councillors to determine the priorities and where the money is spent. Do you not accept that the public have a right to expect that there is an independent review of those decisions and of how the money is spent?

o er P illi s: It is absolutely right, and we all need to make sure that there is that independent sign-off to show that our accounts have been done in a proper way, that they have been properly managed and that their probity is there. That is absolutely vital. The issues about safeguarding, as was mentioned in the previous session, are a given, and they have to be dealt with. Thereafter, you have to ask yourself about the proportionality of the audit. The accountability must clearly be there with your public as to what your priorities are.

In the world we’re living in—let’s be blunt about it—we have so many services to deliver, many of which are statutory, and we have so much money to deliver them with. It isn’t rocket science; there ain’t too many choices. You also have more joined-up working than you’ve ever had before, and we’ve all got to get used to that. In particular, the health service and local
government services will have to work more closely together. We pioneered that in Herefordshire. We were the first council to have a chief executive and a joint management team. But the audit regime was beyond them; they couldn’t cope with it, and that’s your problem.

If we’re going to sweat the public pound to meet the aspirations of the public in the future, we’ve got to make sure that we get the thinking right. That is why the peer reviews are coming in. Local government, holding together the ring of the health and well-being boards in the future, will be absolutely right, under those peer reviews, to do that scope in the right way.

That is the big bonus. If you have two statutory institutions coming in and auditing as they have in the past, ticking their own individual boxes, never the twain shall meet. That’s been the problem, particularly in the health and social care sector, and that has to alter radically in the coming years.

Q114 Bob Blackman: But don’t you accept that if this gets more complicated, the public, whose money you’re spending, will have a right to know whether it’s being spent in the right way and on the right services?

Councillor Peter Fleming: The signing-off of the accounts will do that. The holding to account of your health and well-being—

Q115 Bob Blackman: With respect, the signing-off of the accounts just says that your money has been spent in a proper manner; it doesn’t necessarily look at value for money or whether the prioritisation has been correct. That’s what I’m looking at—that independent review of decisions made.

Councillor Peter Fleming: That’s an important point, and that is what auditing, peer reviews, and the audit regime are all about. It’s not just about the signing-off of the accounts; it’s about the scrutiny to ensure that the decisions that are taken are the right ones.

Q116 Bob Blackman: Absolutely. Councillors Wilcox, do you have a view?

Dave Wilcox: Just two brief points: the priority, rightly, can be set locally. I don’t think anyone has the right to come in to make a judgment on those priorities, but they do have a right to come in and say, “If those are your priorities, how do you know that you’re doing that effectively and efficiently?” I think that is a legitimate role for someone coming in externally.

The other point, which auditors never raised, although they sometimes whispered, is “Perhaps this PFI scheme you’re involved in isn’t really good value for money.” They weren’t allowed, it seemed to me, to ask that sort of question. I think in the new regime there’ll be an opportunity for a fuller and franker exchange about things that come from on high, as distinct from what has happened in the past.

Q117 Bob Blackman: Councillor Fleming, you’re looking quizzical.

Peter le in: Well, yes; I think, on the statement that they check that decisions are the right ones, surely that is down to local politicians to make those decisions.

I think actually we’re in an interesting time. We are not that far away from a number of councils, if the Secretary of State is to be believed, becoming entirely financially autonomous; this conversation won’t ever happen again, because if I raise all my money locally and I don’t have Government money to spend I will make those choices locally and, with respect, you won’t have a lot to say about that. He who pays the piper calls the tune, and if my residents and businesses pay 100% for the services that are delivered locally I shall be listening to them rather than the Minister.

aron a lor: We had a particular problem, I think, with this area of prioritisation, and inspection of prioritisation, as far as districts were concerned. I’ll just give you two very quick examples. In my authority, my county council doesn’t spend a huge amount of money on youth services. It’s a very vital area for my borough, so we have spent quite substantial sums of money on youth services. It’s not our statutory duty to do that, but we’ve done it because it’s a political priority for us. It would have been one of those areas, probably, that the auditors would have looked at.

In my opinion, it’s our judgment as politicians that that’s what we should do. The same applies to transport. In some areas county councils fund transport very well, and in other areas not so well. Sometimes district councils have to pick up the tab for that. I think those are political decisions from our point of view, but I would agree with what Dave Wilcox said—that it’s whether you’re delivering an efficient and effective service that people have a right to look at.

As to how that is done, I think, there are issues that the Local Government Association can look at. Certainly, in the District Councils Network we have done an awful lot of work on preparing best practice studies, and so on, that we can share with other districts, so we know what others are doing. There is the whole regime around scrutiny, and I think that’s vital. A strong scrutiny process in an authority should look at that in public, so that people can come along and see it is being done. That close scrutiny is vital.

Q118 Bob Blackman: That leads me to my next question. Do you think there should be a statutory audit committee in every local authority?

aron a lor: We would want to retain our audit committee, certainly. I think that’s vital.
Q119 Bob Blackman: That’s your choice, but do you think it should be statutory that every authority should have an audit committee?

aron a lor: Yes. I think all authorities ought to have an audit committee, because there ought to be somebody who is independent of the executive looking over their financial management.

Q120 Chair: To take the conversation a little further: should it be an audit committee for the finance or an audit committee that is principle scrutiny by another name and is able to bring in a review of a service if it thinks it is wrong, or both?

aron a lor: Well, I think it’s really for scrutiny to oversee the other functions and see whether they’re working efficiently and effectively, but the audit committee from my point of view would have the power to call something in if it felt it wasn’t being delivered effectively. I think they’re very independent. My audit committee has independent members on it as well, from outside—they are not councillors. They are members from outside the authority. I think that’s good practice too, and I think it’s very helpful if there is that ultimate audit body within the authority.

o er P illi s: Given the size of budgets in county councils and unitaries, proportionality says that you must have an audit committee. I think that the flexibility to have independent chairs or members would add gravitas with the public.

Q121 Bob Blackman: Do you think it should be flexible, or should there be statutory independent members on the audit committee?

o er P illi s: Good practice would say that you should have one, making it flexible and giving them freedom. Those that don’t will have to be accountable.

Bob Blackman: Some may not.

Pete le in : Flexibility is always good.

Q122 Bob Blackman: So you would be happy, if you were raising all your money locally, to have an audit committee that would oversee how you’re spending your money?

Pete le in : Absolutely. It is also very different where you are in the country. In Sevenoaks, I have a hugely engaged public who really hold you to account. If you provide gold-plated services, they’ll want platinum-plated services. In different parts of the country, people’s perceptions are different, and we will probably come on to tease that out a bit further. Flexibility is always the best way. The idea that we can regulate everything is not good.

Q123 Mark Pawsey: Can I pick up on that point? In that case, do you think that there should be a different system of regulation for your authority, where your public are highly engaged, from the system of regulation for another authority, where the general public may not be highly engaged?

Pete le in : But they will be. This is the joy of localism. You can have what we might perceive in Sevenoaks as poorly performing services in another part of the country, and when you ask the public, they might think that they are getting a good service. Is that a problem?

Q124 Mark Pawsey: So you are saying that there is no role for the oversight of central Government in any of the functions and services that you deliver?

Pete le in : Well, that we deliver. It’s important to understand that district councils don’t deliver those safeguarding services. That is a separate issue.

Mark Pawsey: But you are obviously saying to central Government, “Just leave us alone.”

Pete le in : Yes.

Q125 Bob Blackman: Councillor Wilcox, do you have a view?

Dave Wil o : I would go for having a statutory requirement for an audit framework. The role of the LGA and our organisation is to set out a code of good practice in terms of independence and training for the people who are engaged in that, and then to monitor it and, if it starts to come unstuck, to start to intervene.

Q126 Bob Blackman: One final question from me. How helpful do you think that the financial resilience work was with the Audit Commission?

Dave Wil o : It depends on the definition of financial resilience that you want to focus on. For me, financial resilience is about asking, “Are you well placed in your reserves and your capacity to deal with the unexpected?” I think that’s a legitimate concern for audit. Sometimes the term “financial resilience” is used in a different way, and in that context, I think it was less acceptable for the Audit Commission to intervene in the way that they did.

o er P illi s: On the value for money statements, some of that was going into territory that wasn’t appropriate, but for the public to be told that their council is managing it in a good manner and has sufficient and sensible levels of reserves is a useful thing for me to have as an elected member.

Bob Blackman: Moving along the line of witnesses?

Pete le in : I would agree with that.

aron a lor: Yes, I agree with that. One of the things that we struggled with was moving the goal posts all the time on those financial resilience statements. We had worked very hard with our auditors to get to one place, and then the goal posts moved again. It looked as though we had slipped back when it was the target that had moved, not what we had done. In fact, we had improved, or felt that we had improved, but we got a lower score because the Audit Commission had tightened the framework up. I didn’t feel that that added anything to public accountability for us.

Q127 Simon Danczuk: Will better value in local authority audit be obtained without the Audit Commission?

o er P illi s: The proof of the pudding will be in the eating of it. When it comes, I would like to think that it will be. I certainly think that we need some sort of proportionality. We need to make sure that we have enough people applying. As has been said, there would be more interest with colleagues in the district
councils. You are talking about a whole level of public services that still needs some form of external audit to be there. That’s a big market, and I would have thought that there was the willingness and the hunger out there to deal with it.

Simon Danczuk: To bring prices down.

Chair: I should say briefly that we are told that there might be a vote shortly, so if bells go and we disappear please don’t be alarmed.

Peter le in: We’ll just keep talking.

o er P illi s: I would say that there was sufficient market there to generate that level of interest, and if you follow that principle through, there should be that level of competition to make sure that you get sensible levels of pricing and costings, and to make sure that where there is that market you can actually use that to get the most economical price for it.

Dave Wil o: It will partly depend on our capacity as local authorities to procure, and there are two tensions in that: you can go for the cheaper price but not get as good an audit, or you can go for a more expensive one. I think, again, that it’s going to be part of a learning experience for us, and I don’t think we’ve got a guarantee either way at present. We’re going to have to get in there, work in partnership with other authorities and see how we can drive the best possible deals with the highest quality we can get. Then we’re going to have to re-evaluate that, in two or three years’ time.

aron a lor: There is huge value in the service that the LGA is beginning to pull together around sector self-support. I think the decision’s been taken that that will be part of the subscription service, and we will be able to access it free of charge from the LGA. That gives another dimension to us looking at ourselves and judging our own services through peer support. I think that’s really helpful.

On the question of auditors, it’s hard to believe that with a wider number of people there in the market for us to go to this won’t result in better value for money in terms of the service, but I think that colleagues are right: that remains to be seen and we need to let this operate for a little while. The fact is, it has become a huge burden, particularly on district councils—we don’t have huge budgets anyway. The cost of auditing has become a huge and, in my view, disproportionate burden to us. We need to see how this plays out, and hopefully it will be less disproportionate in the future.

Peter le in: The key is, “Don’t constrict the market.” I would really urge you to look at what happened with foundation trusts, where so many hoops were put in that the marketplace was constricted to the three main auditing firms. What we need is a true free market. We need the quality assurance so that we all know we’re going to get a quality audit, but beyond that we must be allowed to have as free a market as possible, with as many people within that market as possible to provide a good pool for us to take from.

Q128 Simon Danczuk: On the County Councils Network, you talked in your submission about having “some form of framework contracts from which local authorities and voluntary grouping can call off.” I just wondered who you thought should be responsible for establishing those framework contracts.

Dave Wil o: I have not given any thought to it. Talk to Roger, and I’ll think of the answer.

o er P illi s: There is a need for a lot of public sector colleagues there. We are going into an ever-changing world, in which we become more like commissioners than deliverers of services. It is a changing market, and so we need to take a lead on that, and we need to take those third sector organisations with us, helping and supporting them in this process.

aron a lor: I wouldn’t have any problem with the sector working with the professional bodies and the industry on those framework contracts. I think that that would be a sensible way forward.

Q129 Mike Freer: There has been much talk about the publication of £500 expenditure. Do you think that will actually drive down costs, or improve scrutiny from the general public?

aron a lor: It is important to remember, and I have to say this everywhere I go, that local government is the most efficient part of the public sector. We’ve done more in terms of efficiencies in the past five years than anywhere else in the sector, and district councils are the most efficient part of the local government family. So, I have no objections to this. It costs us nothing—or virtually nothing—to do it, and if it provides another avenue for the public to look at our spending, I don’t have any problem with it. I think it’s too early to tell whether it’s going to make a dramatic difference. Ours has been published since October, and I haven’t had a mass of public interest in it or inquiries about it, but it’s there if they want it. I think that is healthy and a very good thing. Next, we need to start looking at some of the other documentation we produce. The statement of accounts that councillors deliver is frankly nonsense in terms of the public understanding what we are doing. It has been made worse recently by new CIPFA guidelines that have made the accounting format unintelligible to anybody except someone who is not only a qualified accountant, but absolutely up to date with CIPFA guidelines. The way that they treat depreciation, for example, and make you add it in at the bottom of each line means it is almost impossible to interpret the accounts.

Q130 James Morris: Can I ask a question? Isn’t the issue about the £500 and transparency more—as you alluded to—about how we actually present that information to the public? We should be seeking to publish and distribute all information to the public if possible, but it has to be in a meaningful format in order to be comprehensible. How do we move towards that situation?

aron a lor: This is the way I would like to do it. Obviously, auditors require a very detailed statement of accounts. I would like to see us publishing as much as possible, much more clearly online. The £500 items are fine; that is a start, but we need to go further and ensure that what we are spending and why is transparent to the public, and link in what they have
told us are their priorities with what we actually spend on them. There is a little way to go on that.

**Q131 James Morris:** The other day, somebody coined the phrase “naked transparency” when talking about the £500 limit. You get a list of the items, and anybody can go down that list and say, “Was that right?”, or “That looks a bit too much for that particular thing.” Are there not dangers in that level of naked transparency? It can distort the public debate.

**aron a lor:** It is not always very clear to people why you’ve spent the money with that particular company. You tend to give people a list of which company it is and how much you’ve spent with it. You may list what the item is, but that doesn’t relate to anything in terms of your policy priority and that is the danger. People can come and question things—that is great and we welcome it—but it does not add a huge amount in terms of people properly understanding how their priorities are being addressed with the money that comes from them. That is where we need to go.

**o er P illi s:** I would agree with that. It is an important principle about being open and transparent. You’ll agree that local government is the most efficient sector right across, and we welcome the fact that all public bodies should be open to the same degree of transparency, and that’s got to follow through. I think there is an issue, but that is difficult to say because you are not going against the principle, but you have to be practical sometimes. It is like freedom of information—a marvellous idea, but sometimes if you see the amount of time an officer spends on some of the issues that they are dealing with, you start to wonder where we are going. Some of the vexatious litigants that you get—well, you broadly start to wonder where you’re going and all the rest. That is something that you have to do with because you’ve gone down that line. But you’re right. If you just give people a list, there is a story behind each item, and the opportunity to tell that story is sometimes good. Don’t under estimate, however, the practicalities involved with some persistent individuals who will keep gnawing at a particular bone, and still don’t get the point even when you’ve explained it to them.

**Q132 Chair:** Ministers have suggested to us in evidence in the past that there is room for commercial data aggregators—data miners—to put together interpretable sets of accounts that are comparable across local authorities. Do you think that is realistic without information from you illustrating what is going on? Is there a market? Would you pay for that information?

**Peter le in :** I don’t think there is a market necessarily. Local government is good at procurement, so there is an understanding within the local government family of what things cost and our ability to buy within a group and save money. I’m not sure what would come out of data mining that would necessarily be of any use. The list approach is frankly nonsense; it doesn’t mean anything. It is literally a list of company names and amounts and a day. I want to underline something that Sharon said about the statement of accounts. Our statement has grown from 30 pages to 60 pages. It means nothing to the public. CIPFA seems to be the only organisation that issues guidelines, which aren’t guidelines—they are actually mandatory. It is totally unintelligible even to people who understand local government finance. Your hopes of the public picking up your statement of accounts, like a shareholder in a company might, and being able to understand what has happened in that year, where the money has been spent, what it has been spent on and whether the priorities of the previous year have moved forwards—

**Q133 Chair:** To cut across, is there a general agreement among the panel that reform of how CIPFA demands accounts to be presented would be as useful as almost anything.

**Peter le in :** Yes.

**aron a lor:** Yes.

**Q134 Chair:** It is not something that has come up in discussion before. I don’t know whether colleagues have anything further to say. I agree with you totally. I used to have to reconcile the statement of accounts with the accounts of the authority, and I could never make neither head nor tail of it.

**o er P illi s:** To be fair, they are a professional body of accountants and treasurers. They are not Joe and Jane Public. So, you have to tick the financial boxes, but there should be something that says, “Yes, and this is actually understandable to Joe and Jane Public.”

**Q135 Chair:** But your evidence to the Committee is that there is real value to be obtained by CIPFA being asked to present its data in a more intelligible fashion—something that relates.

**Peter le in :** Yes.

**aron a lor:** Yes.

**o er P illi s:** Yes.

**Q136 Mike Freer:** I get the impression that most of us who have been in local government have been on the end of these vexatious questions from obsessives. Do you think that the right of the individual to challenge the accounts should be swept away or that the bar should be made slightly higher?

**o er P illi s:** No, you can’t do that and we know that. I should say that within the context of this room.

**Mike Freer:** It is broadcast.

**o er P illi s:** Yes. When we are saying this, let’s also recognise the practicalities as well. Again, that is about the opportunity to go in there and explain what these different lines are. In my own council, when they were publishing them, they said, “Why are you paying all these agency staff?” We said, “We have paid more agency staff in the last 12 months because for 18 months we have been preparing for a level of redundancies. We have made a conscious choice to put in agency staff rather than to employ people to make them redundant.” That was useful because I could then explain the situation. From that point of
view, it was very valuable. They thought that they had a particular issue. I explained it and they accepted it.

aron a lor: It was a similar issue on contracting. As local authority leaders, we all get challenged from time to time on the amount we spend on contractors. In the district councils, we keep our core staff to as low a level as possible for efficiency reasons. Then we will want to bring in people to do specific pieces of work for us. If that is challenged by the public, we should explain why we have paid a contractor to do that piece of work. It is a specialist piece of work and we don’t want to keep staff on the books to do that all the time, but we needed them in this particular instance. That is where the £500 list can be quite useful in throwing up those questions that we can then answer in public.

Q137 Heidi Alexander: I was really interested in your comments of the publication of spend over £500. I thought that a number of you gave very strong arguments against the usefulness of this in terms of the public looking at, monitoring, assessing and evaluating the spend of local councils. Previous witnesses have said that the publication of this data may end up in an audit of the weeds as opposed to the big really important questions about the millions that might be spent on adult social care versus revenue investment in roads. Do you agree with that comment about audit of the weeds? Do you think that the idea of armchair auditors is a bit fanciful?

aron a lor: As I said, to me, this is one of a basket of things. If the public wants us to publish that way, we will. It is up to councils to do what they can to make it meaningful. Because they are up against a deadline, they have to do it quickly.

Heidi Alexander: Hold that thought.

Chair: We will suspend for 15 minutes.

Sitting s s ended r a i visi n in t e se n res ing

Chair: I think that for everybody’s sake, we should move on.

Q138 David Heyes: With the absence of centrally imposed targets and rigorous inspection, what’s to stop local authorities from coasting; and, further to that, what risk is there that some authorities will simply opt out of the new LGA arrangements?

o er P illi s: We live in an open and live democracy, and the reason you won’t be coasting is that you’ve got an opposition against you that will soon tell you where you’re going wrong, and you’ve got the press and an informed public.

Q139 David Heyes: Some authorities will be forever blue, and others will be forever red. I doubt nowadays whether any will be forever yellow, but that’s the counter to your argument.

o er P illi s: Yes, but it’s not beyond the wit of man that within individual parties there might be strong comments. There will still be plenty of authorities, taking your point, where there will be a contested strength, and the opposition will therefore be knowing and picking up information—and that will spread. We all know the bench-marking information that we’ve got about different authorities. If local authorities want to opt out, that is one hell of a brave political risk to take. That is the culture that local government will create. If you’ve got somewhere that will be forever one colour, people had better be mindful of that; and they will be exposed by their neighbours. That’s what you do; you create that culture.

Dave Wil o : It is a legitimate concern. I will come back to this issue. There is a large element of “suck it and see” in this process. We could have a significantly better system, if we get it right and our authorities are co-operating, we have agreed benchmarks, but less of them, and we use that benchmarking to continue to drive improvement. You do not necessarily have to have a centralised system to do that.

If that starts to break down and is not happening, we will have to revisit that and say, “Look, in these circumstances we can’t necessarily deliver.” We have to work more closely with Government and say, “This situation, which has always been moving, has moved yet again.” We feel that, at the moment, we have enough authorities with the commitment to sustain an engagement in this process. The ultimate threat for all of us—to any authority that is going out of line—is, “Well, if you want to do that, that’s up to you, but we recommend that the Government send some inspectors in.” We have a number of arrows in our quiver, which we can use to help get some authorities to work with us, even though their inclination initially may not be to do that.

Q140 David Heyes: Will you be helping the backsliders?

Peter le in : He’s talking about Dave.

aron a lor: Is he? I’m sure that Dave’s not a backslider. It is not in the interests of the sector to not do its damndest to make this work. I am sure that all of us that have been involved in the improvement and development part of the LGA will be making as sure as we can that it will work. I agree with Dave: we need to watch this over the next few months and years to see how effective it is. Benchmarking is key to that. We need to work together to provide some rigorous benchmarking, which compares the cost of the service with the quality of it. Although I am a leader in Stevenage, I am also an opposition member in a group of three in Hertfordshire. I have been able to use the quality, cost comparison data very effectively as an opposition member.

Scrutiny comes in here as well. In our authorities, we should have responsibility to provide the kind of information in public that allows the public to see how well we are doing against a set of performance measures. I have a balanced scorecard at Stevenage, while other authorities will have other ways of doing it. I have that every quarter at the executive committee. It is therefore a Part 1 paper and is published, so anyone can see it and challenge it.

The sector-led improvement agenda is vital here. I sat in on the previous session, and there are political processes here, and I am sure that our colleagues who gave evidence earlier will provide detail of that. It is not in the interest of any of us in the political sphere
to see one of our own authorities going under or coasting or backsliding. We will work from that side of things as well, to ensure that that does not happen. The picture needs to be watched by all of us, but it is not in the sector’s interest for this to fail. We want to move away from the kind of targets and inspection that we had before, which were costly, time consuming and took away from us doing some of the things that we want to do, in terms of political choices.  

Peter le in: Just following on from what Sharon was saying, the sector interest one is an interesting thing to follow through. At the moment, we do not have a particularly mature debate about councils in the media, from Government or from anywhere. We pick one or two examples and say that that is the whole of the sector. I look round this table and virtually everyone round it has suffered from the ai view of local government in the past, which is that all local government is bad, wasteful, puts people’s lives at risk, and is full of officers who are doing nothing. That view has been perpetrated over an extended period of time by Governments of both colours. We need to put a stop to that. Part of that is about the pressure that the sector will come under to improve itself in future. It doesn’t matter whether Ministers or the press are badmouthing the sector, that’s not helpful to the sector, and we need to find our own way through it because I don’t think we’re going to get a lot of support either from the media or from Ministers, of whatever colour.

Q141 David Heyes: Sharon mentioned the costly arrangements that there have been previously. Do you have a feel for the likely cost under the new arrangements? The inference from what you said is that you expect them to be less costly. Do you know how much less costly?  

aron a lor: Of course, members pay their subscription to the LGA. Some of the services that we’re looking at—the peer support and so on—will be free of charge. That has been decided now. That’s part of a better value offer that the LGA is trying to put forward. But no, I don’t think we know the cost yet. That has still to be determined properly.

Q142 David Heyes: We need to try to extract it from the overall fee, then, to isolate the figure?  

aron a lor: Yes. We can probably have a look at that and give you some more information on it, if that would be helpful.

David Heyes: The Committee would find that helpful, yes.  

Peter le in: I want to come back on that. Your initial question was about coasting. That is an issue and it’s an issue that is live in the LGA group. We understand that there will be councils that will coast. You have to be alive to that and wary about coasting, but the last group clearly told you there’s going to be less money in local government. I think everyone accepts that. So the opportunities to coast will be far less than they may have been in the past for certain authorities, because difficult decisions will need to be made and those will need to be communicated to the public.

Q143 James Morris: I want to return to the question about areas of serious service failure that we touched on in the previous session. I want to come at it from a slightly different angle. To what extent do you think that the peer-led system that you’re talking about might help to prevent service failure and unearth it earlier than is the case in a top-down, Audit Commission-driven process?  

o er P illi s: Yes, I think there’s a good chance of that. With the established audit regime, everyone was very much in a defensive position. It’s a case of “The Auditor cometh”, so a certain process is rolled out—the carpet is rolled out and all the rest of it. Everyone’s in a very defensive mode. If you know there is a problem, your duty is to try to gloss over it and all the rest of it, because you can’t stand all the publications of it. What you do with a peer review is far more genuine and more open. You will come in and have the exchange. That happens at the right pitch; it’s pitched at a better level. You can also start to work on things when the amber lights start to show. I think people will be more genuine, more honest and more open to the constructive criticism coming from their peers. Remember: this is all about ideas being swapped between your elected members and your officers. It’s about their personal development. It’s about working for the local government family and the whole of the public sector generally, and their reputation and their improvement. On that basis, you will find there is far more openness, because people know that the outcome will be less stark. It will be a case of, “You need to tackle this,” like a one-to-one assessment, rather than having the assessment in front of the public.

Peter le in: I’m going to try to start the mature debate I was talking about here and now. The reality is that people will die in the care of local authorities—point 1. Counts don’t kill people. Other people kill people, whether that’s a vulnerable adult or a child. Until we can start having that mature debate and until the press can start having that debate, our best hope is peer reviews, because what happens after a baby P, what happens after baby P is that the professional practitioners go back to models that they believe are tried and tested and the system doesn’t move on. If you look at all the reports after all the issues that we’ve had over a number of years, whether we’re talking about Victoria Climbié or baby P, what happens is that the professionals retreat. What you will get from peer review is an opportunity, in a safe environment, for professionals to talk to professionals, to share best practice and to move things on—something that isn’t happening at the moment. But that has to be under the umbrella of a mature debate. There will be another baby P. Nobody wants there to be, but there will be.

Q144 James Morris: So the mature debate that you’re talking about is a prerequisite for your peer review system working in practice?  

Peter le in: I don’t think it’s a prerequisite, but I think it’s really important that we, as a country, have that debate about those critical services because such incidents will happen again.
Q145 James Morris: Could it make the situation worse? If, for whatever reason, we are not capable of having the mature debate, doesn’t your peer review potentially make the situation worse, because if something goes wrong then the public, driven by the media, will say, “Well, with peer review they were just talking to each other about this problem and nobody was gripping it”? Peter le in: But as the last panel told you, critical services will still be inspected. Ofsted will still inspect, and—is it the Care Quality Commission?—will still inspect too.

Q146 Chair: But the question is more general, is it not? Let’s talk about bin collections, or let’s go to planning. There is appalling service in the planning department. When it has been inspected by outside auditors—well, they are actually other councillors. I think that the point is well made. Peter le in: Welcome to localism. The trouble is that what we have had is a mentality that all councils have to be the same, they all have to provide the same services and they all have to provide them at this level. We are entering a new world and you will get variation. I think that variation is good—I don’t have a problem with it. The public have an opportunity to change things. I know that it’s scary for politicians.

Q147 Chair: Okay. I get localism. It’s driving me forwards, I have to say. But there is a difference between variation of service and service failure. If there is a service failure, it might be a minor one in the planning department but it might be rubbish. I think that my colleague’s point here is that if you have a panel of other councillors saying, “It was okay,” does that not perhaps undermine things? Peter le in: We need to be careful because, with respect, the question was about critical services. The definition of critical services is something that kills you or puts you at risk.

Q148 Chair: I understand that, so let’s expand it to non-critical services. o er P illi s: But the process isn’t just, “I will come and have a friendly chat with you.” Part of the engagement will be wanting to know what the public feedback is from the people in the area and they will pick these things up from the businesses in the area. They will say, “You’ve seen their planning system at work,” so that will be part of the challenge. They will say, “You may be telling me that you’re running a very good planning service, but when I talked to your businesses they said you were appalling.” That is part of the peer review. It isn’t just, “Oh, we’ll sit down and have a cosy chat with you.” Part of it is that engagement with that community. They will say, “Tell me why you think that the businesses in your community are telling me that you’re running a rubbish planning service?”

Q149 James Morris: Does that not also reinforce the point that we touched on earlier about the importance of driving this accountability to residents through better provision of information? I think that we were talking about the national indicator set earlier. Wouldn’t it be a good idea to have the local authorities choosing which indicators they wanted to pursue and linking that choice to the information, in order to have them held to account by local residents? Would that not be a start in the mature debate that Councillor Fleming is talking about?

Q150 Simon Danczuk: You said earlier that benchmarking will be key to this process and there was some agreement about that. What is to prevent an authority from not benchmarking a service or from not releasing its results if it considered that those results indicated that it was providing a weaker service? What is to prevent those things from happening? aron a lor: Obviously, we have to stand for election every four years, and if the public see us as not being willing to release information about what we have done, they would probably want to know why that was the case and they might not choose to elect us the next time round. Regarding the peer support and so on that happens, I think that for those authorities that are members of the LGA we would come to an agreement that that is part of the process of what we are doing. If we’re going to regulate ourselves, we have to agree that there is an overriding view in the LGA that we want to be transparent in what we do, and that means ensuring that information is published. If authorities are stubborn in this and won’t do it, I think that is very much part of the sector-led process and when we go in. I do not think it is a soft option by any means, because these are groups of peers, they’re cross-party and will not be a soft touch. They will say, “You haven’t provided any benchmarking data, why not?” They will ask some very tough questions of the authority concerned. I don’t think that this is a soft option by any means, and the benchmarking data are pretty hard data to go by. Transparency in that form can be judged by your own scrutiny councillors, your public and your peers from the peer-support process.

Q151 Simon Danczuk: On that, the public aren’t aware of what benchmarking information is or isn’t produced by a local authority. They do not follow the
Councillor Peter Fleming, Councillor Roger Phillips, Councillor Sharon Taylor and Councillor Dave Wilcox

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Q152 *o er P ills*: There is a clear issue in that we are moving into an area where you will have to deliver services with less money. If you can’t be bothered or are not going to produce your performance figures because basically you aren’t doing your job properly, you won’t be doing your job properly, so never mind producing the performance figures, you’ll be caught out by some other means. The public will see that you’re not cleaning the streets properly or that the potholes are getting bigger and bigger and nobody is doing anything about it. Never mind that you don’t have the performance figures, the truth is there on the ground. That will be the thing, and dare I say that even the MP will probably write, make a big statement about it and whip them, whoever is in control.

We must recognise that across the board, people and the press know—it will be the culture—if you are doing something in your authority and next door they are not, and people travel. You only have to ask about recycling and they say, “What do you mean you’ve got one bin? We’ve got nine. This is insane. Why do we have nine bins and you only have one? Ours is collected only once a fortnight.” People have those conversations. You may think that they ought to have something else to talk about, but they start to compare authorities. They meet up across the country and do that.

*Peter le in*: Speaking from a district council perspective, we provide services that people notice every day. You would notice if your bin wasn’t collected, you would notice if your street—

Q153 Simon Danczuk: With due respect Councillor Fleming, I was not talking about what services are and are not delivered and when the public notices. I was on about the figures that are collected. That’s the point I was making. I know they notice when their rubbish isn’t collected.

*Peter le in*: But what was interesting was that you said that under the new regime the public won’t have a clue. But the public aren’t paying any attention to the data at the moment. A new system is coming, and, hopefully, it will be a more transparent system. It will be a system where the language that we use is not the language of the centre, but a language that is understood locally about service provision and about the services that people actually have. I was collecting data on galleries and museums, but I don’t have a gallery or a museum. What purpose does that have for my residents? I think you will have a more engaged public with benchmarking on services that people get delivered in a language that people understand, rather than the language we have been dealing with over the past few years.

Q154 Mark Pawsey: It is clear from the evidence our witnesses have given us that few tears will be shed over the demise of the Audit Commission. I want to ask a question on the best value report, which would provide some accountability to Parliament. Parliament would bring information together. Do you not think there is still some role for the Audit Commission to carry on that work?

*Peter le in*: It’s not for the Audit Commission to decide whether we are providing value for money. What is interesting is that those councils that have really achieved will continue to get that work provided, not necessarily by their auditor but by somebody else. Those that want to really improve will continue to have that done, but it should not be statutory and it should not be done by the Audit Commission.

Q155 Mark Pawsey: But who is going to aggregate the data? Are peer groups going to come together to do that? Will that be part of their remit? One of the bigger questions, I suppose, is: will there be a broad enough view? If you create small groups in peer review, will there be enough data to get a picture of what is going on?

*aron a lor*: What I thought was very helpful were some of the thematic studies that were done. I am thinking in particular about one that relates to asset management and those sorts of things, where a collection of case studies formed, in the end, a framework that you might want to look at. Those kinds of studies were really helpful, but I think they can be done on district council services by the District Councils Network and on county council services by the County Councils Network. I think that we can provide just as adequate a service on that as the Audit Commission did. That is a very helpful function. It would add something to the Local Government Association. We do some of it already, but that is something we can usefully take under our wing and make sure that we are providing those services.

*o er P ills*: I agree with that.

Q156 Mark Pawsey: So there will be no role left at all for the Audit Commission as far as you are concerned.

*Dave Wil o*: Not for the commission as an institution, but there will be some functions that we will need to examine and re-examine to make sure
that they are being performed. If they are not, we might come to our partners in Government and say, “Look, we can’t seem to make this work. We need to work with you more closely. Perhaps you can help us in this particular way.” This is an iterative process; it just goes on and on and on, and it changes. We feel that, at the moment, we are in a position where we have had over-inspection and over-bureaucracy, and we are moving to a new situation, but we are not moving to it without an understanding that there is a wider responsibility, because we can’t escape judgment and we need the information to show continually that we are improving—that we are getting better and moving on. It is in our interests for those data to be collected across the whole of the sector, and we see our role as trying to ensure that that happens.

o er P illi s: And there is a clearer territory of finance probity and governance.

Q157 Mark Pawsey: But who is going to do this collecting? Who is going to play this co-ordination role that is currently being played by the Audit Commission?

o er P illi s: Our own organisation and own family of organisations can do that, collect that information and hold it up. We, as the County Councils Network, know who from the current regime are performing strongly and who are performing less strongly, so all that detail is shared with us on a county council basis so that we recognise all of that information. You use that information with your officers, with your leaderships and, of course, with your opposition members as well. It is that political tension that you have in there—never forget that you have that—that also provides you with the extra incentive to get it right.

Mark Pawsey: Thank you.

Q158 Heidi Alexander: I was going to ask the same question that the Chairman asked the previous witnesses at the end of their session: given everything that we have heard, do you believe it was right to abolish the Audit Commission, or do you think there was a way in which it could have been reformed? I might be able to guess some of your responses to that question, but feel free to answer it if you wish. It struck me that a witness in the previous session, Peter Lacey, said that there is a danger that we might agree that the Audit Commission had grown too big and was not doing the job that it was initially set up to do. I am a huge fan of letting it float off as quickly as possible so that it is in the marketplace and ready when there is a more open market. There is experience within the Audit Commission; we should not forget that it has some good people. It needs to get fit for the market. It will have some shocks when it enters the marketplace, but I think it will get there.

I am more positive and less pessimistic than Sharon. I think this is a positive step forward. The sector needs to step up; the best parts of the sector will and the poorest parts won’t. We have to be relaxed about that. This is the world we are now living in. There will be some rubbish councils and some better councils. The rubbish councils will come under pressure from their electorate in this new world, because everything will be in far sharper focus than it is at the moment. At the moment we hide failure.

o er P illi s: Ditto on the comment about the Audit Commission. We need to drive improvement consistently. We have a population and public that have rising expectations year on year, and we have less money. That will change the very culture of local government. There was a time when money was coming at it left, right and centre and it was told, “You will spend money in this direction,” and all the rest of it. The fact that that is there means that there will be fewer places to hide, so, therefore, as a local government family, you will drive that improvement collectively and you will be almost shamed if you do not. The ultimate shame is that, as officers, you will be stained as to where you have been spending your career, and as members you will lose and be thrown out by the public. Those are pretty salutary lessons. That is why I have confidence that it will change, because we are moving into that very different era.

Dave Wil o : I don’t think it is acceptable that there should be any rubbish councils. I see the local authority family’s function as being to try and ensure that there is a system that is appropriately proportionate, that looks carefully and what is happening, that intervenes to ensure that there are not any rubbish authorities, and that re-evaluates the situation if it finds that some are too hard a nut to crack, because that is absolutely unacceptable.
Chair: Thank you very much indeed for your time today, and I am sorry to have abandoned you for 15 minutes or so.

Peter le in: We had a great discussion.

Chair: It has been a very valuable session. Thank you for your time.
Monday 14 March 2011

Members present:
Mr Clive Betts (Chair)

Heidi Alexander
Bob Blackman
Simon Danczuk
Stephen Gilbert

Mr David Heyes
George Hollingbery
James Morris
Mark Pawsey

Examination of Witnesses

Witnesses: Simon Parker, Director, New Local Government Network, Jessica Crowe, Director, Centre for Public Scrutiny, and Ben Page, Chief Executive, Ipsos MORI, gave evidence.

Q159 Chair: Good afternoon. If we could make a start. Welcome to our third evidence session in the Inquiry into the Audit and Inspection of Local Authorities. For the sake of our records, could you introduce yourselves and say which organisation you represent?

i on Parker: I am Simon Parker, Director of the New Local Government Network.

essei a ro e: I am Jessica Crowe, Director of the Centre for Public Scrutiny.

en Pa e: Ben Page, Chief Executive of Ipsos MORI.

Q160 Chair: Right. Thanks very much. Could we just begin? Obviously, the Government has made a political decision to abolish the Audit Commission, and it is not necessarily our job to go back and revisit that as such. But would you say, looking at where we are at now, that this has happened because the Audit Commission really was no longer fulfilling a useful function, or do you think that the Government has decided to abolish it because of concerns about certain aspects of its work, and has put at risk some valuable work that it was actually doing?

i on Parker: Everyone is looking at me. Okay, I can start on that. Firstly, I think it is important to separate audit and inspection. I think, when we got to the election, there was a broad consensus across local government and elsewhere that perhaps inspection regimes had become too heavy, too complicated, too much data, so I can see a case for scaling back inspection, and I think the Government's approach of trying to create local self-regulation is probably, on balance, to be welcomed. On audit, I think the case is less clear. I did not get a great sense from the local-government community that they had a big problem with the Audit Commission's role in audit. The question is: can you make a more localised and decentralised audit system work? You can, but you need to do a bit of work and a bit of thinking to do that.

essei a ro e: I think I would go along with that. I think there were three reasons why total abolition of everything, as opposed to reforming the bits that the Government and others, as Simon has said, were unhappy with, was a mistake. I think it is particularly also the way it was done. I think it is unclear what the evidence was, and there were a number of wild reported reasons given, which have been refuted: the Audit Commission staff attending days at races and that sort of thing, which was clearly found to be untrue; claims that it exceeded its remit. I do not think using those sorts of errors to justify a reason is good when you are making a decision about a framework of good governance.

I think there has been uncertainty because it was not clear, before the announcement to abolish was given, what was going to replace it, and I think that was a mistake, because it has led to uncertainty and, I think, unintended consequences. That is where I would endorse what Simon said: unhappiness with the previous inspection and performance regime could absolutely have been dealt with, but it is unclear that the audit system was broken. That is a by-product of sweeping the whole thing away.

en Pa e: I think the Audit Commission did valuable work. I think the early version of CPA was important in actually shining the light into certain parts of local government where it had not been shone before. There were criticisms about the reach and scope of the latter part of the regime, CAA; whether those would mean that the Audit Commission itself had to be abolished, I would probably wonder whether that was strictly necessary.

I absolutely welcome the idea of more self-assessment and proposals, for example, that the sector can police itself; however, I am sceptical as to how that will work in practice and I do think some form of independent inspection is also supported by the public, which is in the evidence that I submitted. I have also given you today a copy of one of the more recent studies of what people being inspected by the Audit Commission said about it, and that is a properly representative cross section of both local authorities and other bodies. You can see more of them are positive than negative about it.

Q161 James Morris: As you were saying, Mr Page, we have lived through a period where top-down performance management, arguably, over the last 20 years was necessary in local government, but don't you think we have reached a point where we are moving into a different age, which demands innovation, and what that demands is local government to take more responsibility for its own evaluation of its own performance, and we do not need an external body looking over the shoulder of local government, and local government is perfectly capable of, on a peer basis, dealing with its own issues of performance?
en Pa e: I would like to go along with that, because, in theory, of course, we have local democracy in this country, as we always have done and, in theory, the voters of Hackney or Lambeth could easily have just voted out their badly performing leaders, etc, etc, and got better ones in, and the sector itself had all the machinery it needed, in theory, to police itself. Certainly, top-down, imposed standards lead to minimum floors. All of this is obviously deemed not to have worked, but I would say that I think the evidence still is that, without some sort of comparison between authorities on a like-for-like basis, whether that is the sector itself producing it or somebody else—and I am not saying roll back the clock—I do think that in itself is very helpful. If it is solely generated by the individual authorities, you will get gaming.

Q163 James Morris: Can I just ask Mr Parker a quick question? You said that you thought there was some argument around the removal of the inspection component of the Audit Commission. As somebody who runs a think-tank, have you got evidence around the negative impact of the previous inspection regime on local government? A lot of local-authority leaders that I have spoken to talk eloquently about the burden which CPA and CPA placed upon them. I wondered whether you had any insight into that.  
i on Parker: You have pointed to some of the things already. One is the burden, which is well recorded; the other is the issue of satisfaction, which did not track the results of things like CPA. I suppose a third point would be about innovation. The previous inspections were very good at punishing failure. By and large, if you got a terrible CPA score, the ruling party lost office. There was not a similar reward if you performed very well. It has been said that the Coalition’s approach—and I think it is particularly true of local government—is one of creative destruction, and it is about the balance between those two words. I think the last Government and inspection regime was often so worried about the destruction bit that it clamped down on the creativity as well. The approach we are taking now is clearly on the other foot.

Q164 James Morris: Do you think it might have been possible that the regime of CPA CAA actually had a negative impact on local-authority performance because of the fact that chief executives and officers were constantly looking upwards to conforming to the CPA CAA framework, rather than actually delivering for their residents?  
i on Parker: The evaluations I have seen would not support that, because the local authorities generally improved internally and did improve their services, although perhaps not always in the right place and perhaps not always connecting with citizens. But as organisations I would say probably the vast majority of councils are better run today than they were 10 years ago, and inspection is part of that.  
en Pa e: That is what the sector themselves actually admit. They say although they thought it was burdensome and it was too expensive, they say that they would not have improved as much without it.

Q165 James Morris: It is an improved performance in the context and the structure that has been imposed, so it is answering its own question in that respect.  
en Pa e: I think there is an element of that, but I think the question we have to throw back to anybody who is inspected and regulated, and complains about it is, “What would you have done differently without that?” If I look at some of the biggest failures in local government, both in district council and in some of the better known urban authorities, where there were clear problems—I am thinking of places like Watford—they were good examples, where the administration thought it was doing a pretty jolly job, and it was only when they were named and shamed that things moved ahead. I absolutely take the point about top-down imposition of certain priorities sometimes from Central Government that perhaps did
not always correspond to exactly what local people would have seen as a priority, although it is true to say that, if you allow just the local electorate to determine exactly what was provided locally, lots of things that were actually illegal would happen, because the public’s priorities are different from those of the state as a whole or, indeed, the overall responsibilities of local government.

**Q166 David Heyes:** I want to ask you about the self-assessment and the internally driven improvement, and the role that scrutiny might play in that. I have to say my days in local government were under the old committee system, but I still speak to many local councillors—backbench councillors, as they are now called—who complain of being disempowered and sidelined, often by over-powerful chief executives and council leaders. I think what I want to ask is: is there any evidence, perhaps from other areas, that scrutiny by local councils will be a better driver of improvement than the external inspection?

**essi a ro e:** I think there are examples of effective scrutiny. I think, for 10 years, since the 2000 Act, which brought in the separation of executive and scrutiny, we have been hearing, “Scrutiny is not effective. It is very patchy. It is the lion that has failed to roar”—all of those sorts of metaphors. I think that there is plenty of evidence now that shows what conditions should be in place in order to have effective local scrutiny by those who have been democratically elected, and I think that is absolutely the right place to start, with improvement and challenge on behalf of local residents. It is about adequate resourcing; it is enabling people to have independent research support and a small discretionary budget to enable them to have their own sources of information, so they are not reliant on the chief executive or the administration; it is about effective leadership, and there are lots of examples of very effective scrutiny chairs who have delivered real change.

High-profile ones would be Councillor Len Clark, Chair of the Children’s Services Report in Birmingham, which got national regional coverage for a very, very challenging report into very poor performance and has resulted in his recommendations being taken on board by the ruling group. It is worth remembering that he is a member of the ruling group, so it can be done within a party system. Another example would be Councillor Robert Parker, who is the opposition group leader in Lincolnshire County Council and chairs their Value for Money Committee. He was recently commended by the leader of the council for the challenge that he puts that leader under.

I think that leads on to another success factor, which is about having a culture in the organisation, which does have to come from the top, that values and recognises what independent critical-friend challenge can bring to improvement efforts. I think it is very easy to blame scrutiny for not being very good, but I think the answer does lie at the top in ensuring that the whole organisation values it and resources it effectively to make sure that it can contribute. I think, with those things in place, those would go a long way towards enabling scrutiny to play the kind of part that it will need to play. If there is not the external national scrutiny, it needs to happen at a local level.

**Q167 David Heyes:** I want to hear your colleagues’ views on the same question, but is it not the case that the examples you have given of really good practice are very much the exception? I could top it with hundreds, possibly, of examples where it has not worked.

**essi a ro e:** It is quite difficult to determine what is effective because, quite often, recommendations will be accepted by the executive, who will then claim credit for it and say, “It was our idea all along,” so providing the evidence to say, “Actually, it was scrutiny’s idea that suggested it,” is one thing. If you want to look for metrics, there is information in our annual survey, which we are just about to publish. I can certainly make that available to the Committee shortly. Our survey shows the percentage of recommendations that are accepted and those that are then implemented—because that is also important—is high and has been rising. It is unsung. It is lots of small things. It could undoubtedly improve, but I would say that, yes, the outstanding practices are outstanding because they are unusual, but there is a lot of highly effective work that goes on on the ground. It could be more effective, but that is down to the leadership of local authorities to resource it and support it.

**en Pa e:** I am supportive of it but I do think it is often under-resourced and sometimes lapses into party politics. There are good examples. Actually, some of the best examples have ex-committee clerks from the House of Commons supporting them, where you start seeing people asking some really interesting and intelligent questions. There is a question. I think it is partly about the extent to which the authority really wants to use it, and makes the process its own and uses it effectively, as opposed to seeing it as something that it is obliged to do and it is, therefore, used for just scoring cheap points.

**i on Parker:** I suppose I do not have a great deal to add to what my colleagues have said. I suppose what I would add is that, of course, we need to look broader than scrutiny to see where the new pressures on local government will come from. We may get into this in a minute, but many of those will come directly from citizens themselves.

**Q168 David Heyes:** We have had 10 years to get this right, and clearly it is not right yet. If this is going to be the inspection process or part of the inspection process in the future, it is absolutely vital that it is got right. It has taken 10 years of failure. How can we be confident that it will play a real role?

**essi a ro e:** I would not accept that it is 10 years of failure; I would say it is 10 years of slowly getting better. It is a slightly different thing, but it is also true that it is not linear in either one or another direction. Because it is dependent on a culture and on leadership, when leaders change, as they do as a result of elections, when individual chairs move on and change, then authorities can go backwards or forwards, so it does absolutely vary.
I think there are a couple of key things that, if your Committee was minded to impress upon the Government that this is an important component of going forward, could make a difference. One is to learn from the experience of health scrutiny, which is quite widely acknowledged by academic research, as well as work that we have done, as being amongst the most effective examples of scrutiny. I think that is quite interesting because it perhaps suggests the importance of independence, in that there is less politics involved. We can all agree that we do not like what the primary care trusts are doing—you do not get into the "it is your side versus my side" kind of approach—but also, arguably, health scrutiny has stronger powers than broader scrutiny. It has the power of referral to the Secretary of State and it has real powers to require attendance to provide commentary on what NHS organisations say they are doing.

I think those are two things that we suggested in our evidence should make up part of the new framework, which is a power to refer if local scrutiny feels that its recommendations are being ignored, that it is not having an impact because the leadership chooses not to accept it. It should be able to formally refer those concerns to, for example, the external auditor, to inspectors, where they still exist, if it was in children’s or vulnerable adults’ services, for example, to require an external look or potentially also to the Local Government Group’s sector-led approach to say, “We do not think everything is right. We need some support to improve things.” That power of external referral would be an important weapon in scrutiny’s armory to give it some real teeth.

Q169 George Hollingbery: You partially answered the question there, but I just wondered if the experience of parliamentary select committees and their effectiveness and potency is any great indication as to whether scrutiny in local councils will do very well.

essi a ro e: I think it is because, arguably, select committees are also a recent invention—they are only slightly longer than local authority scrutiny committees—and it is very noticeable that the resources available to Select Committees have increased over the years. I think that does offer an interesting model. Most scrutiny committees in local government would give their right teeth to be as well resourced by the excellent clerks that you have and the quantity as well as quality—he did not pay me to say that. We try and bring the two national and local scrutiny functions together, and I have argued to select committees before that there is benefit in more connection between national and local scrutiny, and we have facilitated a sort of secondment process.

Q170 George Hollingbery: The fact is, without that right to call in, without the right to refer it to third-party auditors, without this Committee being able to say to the Secretary of State, “You come here; we are going to tell you what to do”—of course you can do that in health because these people are not elected and there isn’t the excuse, “Well, actually, I am liable to the ballot box,”—it is not going to work, so your recommendation has to be taken up for this to be effective. Is that right?

essi a ro e: No, because I think where the culture accepts and the leadership accepts the value of being challenged and being open to scrutiny, then it can work on a goodwill basis, and a lot of it has worked.

Q171 George Hollingbery: Yes, it can, but to be universally acceptable as a mechanism, it is going to have some level of compulsion.

en Pa e: If you are going to abolish central inspection and rely on this to do it, then yes, you would want to beef it up.

essi a ro e: Yes, at least to provide assurance, you would need to.

Q172 Heidi Alexander: Just to explore something that has been touched on already, which is the interplay between scrutiny and the politics of a council, I just wonder: if scrutiny is going to become more important in terms of holding local authorities accountable and making it transparent, in your experience, how does the politics work best? From my experience in my own local government career, the scrutiny side of things often worked best when there was more political balance on the council as opposed to one political group having a very large majority. I just wonder, particularly from Jessica, what your overall research shows in that respect.

essi a ro e: We can certainly do some detailed analysis from that. We do have an analysis in our survey of political control and stability, which does seem to be important. I think, but it can work in all sorts of different contexts. If you get an enlightened leader, even with a huge majority, that is willing to tolerate some dissent in their backbenchers, then you can get creative and challenging scrutiny. I think there are a number of examples that I know of where, if politicians know they could be on the other side come the next election, they are perhaps more likely to design a system that works whether you are in opposition or in the ruling group, because they know that they could be in opposition themselves next time. There are examples of quite innovative approaches, where the council has taken the view that policy review broadly more supportive, perhaps, of the direction of the administration should be something that can be left to the ruling group, but they are very clear that the scrutiny aspect is left in the hands of the opposition—is chaired and led by opposition members. On the other hand, that may not work well, and this could be down to the opposition as much as the ruling group. It does come down, as I say, to this political culture; to keeping your governance arrangements under review and assessing whether they are fit for purpose and delivering what you want. As leaders, how honest are we about our shortcomings and our willingness to be challenged? That is, as you will know, not easy.

Q173 Bob Blackman: Could I just lead on from that? Jessica, do you have any recommendations or suggestions about the role of scrutiny in a local authority and whether it should be chaired by the opposition or by the majority group?
Q174 Bob Blackman: I will move on to the area that I really want to ask a few questions about, which is the external approach to this. I think, Jessica, in your evidence, you have suggested that your organisation could act as an honest broker to which referrals could take place. How would you envisage that working?

Jessica Crowe: I suppose that was to partly address the point that has been touched on, which is that scrutiny is liable to be politicised and, therefore, referrals such as what we are recommending might have politics played with them. It was to be able to say, “On a prima-facie-case basis, this piece of scrutiny, this challenge, looks to be evidence-based, it looks to be robust, it meets our principles of effective scrutiny that we have developed over the years, and therefore it is a serious case to answer and the appropriate agencies should investigate it further.” It is really to say there should be some way in which scrutiny recommendations can be almost validated, not for the detail—we would not be second-guessing what had been done at a local level—but to say, “Yes, this is a serious piece of work that has been considered.” It is almost like the Independent Reconfiguration Panel in the Department of Health makes those independent recommendations to the Secretary of State about the validity.

Q176 Bob Blackman: Would this then be something that local authorities subscribe to or would this be a mandatory requirement?

Jessica Crowe: If it was part of the Local Government Group’s self-regulation, then I would argue—and I would argue to them—that it would be a useful tool that would bolster their self-regulatory approach. We are an independent charity. We are not funded directly by any one single organisation. We have a range of sources of funding. We could provide that independent balance using our expertise in scrutiny. It could be done by any other organisation, to be honest, that met those criteria. We are suggesting it because it is something that we would know how to do, but I think it is being able to provide independent advice to those that, ultimately, would have to decide whether there was some external improvement, support or intervention along a continuum.

Q177 Bob Blackman: Simon, can I ask you: what is your view of residents being able to refer things to some external body when they think there is a serious concern?

Simon Parker: We think it is quite a good idea. We have suggested that, with self-regulation, that body should probably be the LGA, so we would be very supportive of the idea that you could use a petition mechanism to trigger some sort of external review if services were badly failing citizens.

Q178 Bob Blackman: How would that work? Are you talking about a trigger level of so many voters or a particular serious issue? How would that function?

Jessica Crowe: It is a good question. It could function in a whole range of ways. I imagine it would probably be a certain percentage trigger level. You would probably want to set that. 5% is very large. That is what we have used for mayors in the past, so it would probably need to be a bit lower than that. Obviously, triggering an external review probably means that, in the first case, you bring in peer reviewers or someone to take a look and see if there is a case for going further, so it need not be overly bureaucratic.

Q179 Bob Blackman: Obviously, one of the issues in any local authority is whistle-blowing and, actually, if there is something going wrong, possibly referring it to an external agency. If you have a trigger level for local people, that does not allow people that think there is an issue to actually get that onto the agenda quick enough.

Simon Parker: No, it does not, although that feels like a slightly different thing than citizens arguing about corporate failure. This is about an individual whistle-blowing about a particular problem. I suppose you would have mechanisms like the Local Government Ombudsman that would be able to tackle that. One of the recommendations that we might talk about later that we are thinking about is setting up semi-independent audit committees for local authorities, and those bodies might be a place where you could take a complaint to anonymously.

Q180 Bob Blackman: One of the concerns, for example, about the Standards Commissioner was frivolous complaints, which then ended up with long delays, nothing happening, and the Sword of Damocles hanging over either councillors or whatever. How do you avoid that as a route when this external mechanism might be triggered?

Jessica Crowe: It is a good question. I must admit I have not thought a great deal about it, so perhaps one of my colleagues would be better placed to talk to it.

Q181 Bob Blackman: Ben, do you have any view on this, because it is a public issue?

Ben Page: If you do use the audit-committee approach, I guess there will be some level of discretion about what they look at and what they do not, and whether they ask for evidence rather than just making an assertion. I think how much one demands of these processes in terms of due process, etc, etc, you end recreating, at a local level, some of the things that you have just abolished in the large national organisation. There is going to have to be some balance struck.
Q182 Bob Blackman: Sorry—one of the recommendations coming forward is semi-independent audit committees, which then require staffing, support, extra costs; at the same time, you have scrutiny cost, extra support, extra assistance. This all sounds like a large-scale bureaucracy growing back at a local level.

en Pa e: I am not recommending this.

essi a ro e: I would say, compared with the previous regime, scrutiny’s support in local authorities is very, very minimal. We are talking declining discretionary budgets, not increasing ones, at the moment, and declining support staff at the moment, not increasing. The trend is against that. I would say we have always argued—very gently, because we do not like to disagree with CIPFA—that audit committees and scrutiny functions should not be quite as divorced as the current guidance suggests, because we think there is benefit not only in sharing resources in terms of saving money, but also that they can well inform each others’ work; that audit purely on the due diligence and proper decision making should also consider the outcomes and the impact of that expenditure, so there is value in those things coming together, in our view.

en Pa e: The other option, if there are going to be auditors in some shape or guise, is to let them hear from people, but how much they will charge depending on the volume of these things they receive, I do not know.

essi a ro e: Commercial auditors probably charge more than a scrutiny committee.

Q183 Bob Blackman: The issue would be that auditors would audit the books and ask whether the money has been spent in accordance with the proper procedures, etc, not over the services.

Q184 Heidi Alexander: Do you think it is important that there is a data set that exists nationally of independently produced statistics, data that the public can look at and compare their own council services with those provided by other councils?

en Pa e: Personally I am a data geek, so I think it is useful, I think it is helpful. I do not think we should expect the whole public or millions of people to want to look at it, but the existence of such things, the ability to make valid comparisons between authorities, both in terms of overall performance, and obviously in terms of what I do, in terms of what people think about them, I think is helpful. Certainly you need the performance data on a like-for-like basis between authorities, and it should be useful for authorities themselves, quite frankly, but it does need to be on a like-for-like basis.

i on Parker: I very much agree with that. Obviously the idea of self regulation involves local authorities voluntarily putting some of that data together, and we will see how well that works, but it is highly desirable to have comparable performance data, and unit cost data and spend data, because then local people, if no one else, can see how their local authority stacks up. How do you know whether your refuse collection service is efficient if you cannot see it in comparison with others? I think that has to be a really important part of a self regulation approach.

Q185 George Hollingbery: Can I just ask very quickly, that data, was it useful before, and is it useful, now? When I was a councillor in charge of performance management—a laughable term as a district council—there were lots of statistics, which we calculated in a certain way, which were always different in other authorities because of constraints. I just think about, for example, the fact that Winchester City Council had 43 different conservation areas; that is not the same, is it, in others? How do you make these data sets work?

en Pa e: If the sector is going to regulate itself it needs to have a long, hard look at its willingness to accept that things will not always be great, and there is a real tension in having an “industry body” like the LGA, which relies on membership subscriptions, doing self regulation, because it needs the subscriptions, and ideally you want it to be able to strike off people who are not performing, and burn their insignia on the steps of LGA house, and then, with a brass band playing, invite them back in again when everything is better. Whether the sector is willing to do that in a way that, in extremis, some of the previous regime would do is debatable. It is that discipline for the like-for-like data, and absolutely I take your point about the problems of comparing different areas: nothing is ever going to be perfect, no two areas are completely identical, some have more conservations areas than others and so forth, but at least you can have a really good go at it and be clear about what the differences are. It is a bit like why Kensington Chelsea and Westminster have some of the highest levels of satisfaction with parks: their parks are very good, but they also have the Royal Parks in the middle, so you do have to bear these things in mind.

Q186 Heidi Alexander: You touched upon the new proposals from the Local Government Group for self regulation, in effect. Perhaps I will ask Simon and Jessica, how confident are you at this stage that those proposals will end up being adequate, and how do you think the LGA can avoid the problems and the criticisms that were levelled at the set of data that the Audit Commission put together?

essi a ro e: I think anyone would share the sort of concerns that Ben has outlined. The LGA is a membership body and unless you have mechanisms for expelling people its levers to pull are going to be limited. That is why I think the strength of the framework lies in the focus on improvement, perhaps, rather than regulation, and that might also avoid some of the problems that we had with indicators that were collected under the previous regime where, because it was all so high stakes and connected with your ratings, your performance, and your league tables, it laid itself open to gaming. We had that when I was a councillor: we were always being criticised because our waste collection per head was a million miles higher than everybody else, and we would try and understand why this was. Of course, it turned out that other authorities were getting away with not including...
any of their corporate overheads, so obviously their costs were less, but we were constantly the ones being criticised for being so out of line.

The stakes were there that encouraged gaming. If it can be focused on improvement, and this data being a tool for authorities to improve their own performance because that is what residents need and expect, there is potential for it to be a better system. It will require a lot of work and support from a range of organisations to bolster the group as a whole, and that is partly where our suggestion came from. This partly comes from our research, which said if you are going to have real accountability it needs legitimacy, it needs credibility, and it needs utility to make it work, and you cannot have all three. Arguably the LGA has legitimacy, because it is the voice of democratic elected local government; I think the credibility is where it needs to strengthen its arm to make that system work.

i on Parker: A lot depends on the maturity of local government. Admittedly the ones who tend to be our members are a self-selecting group and tend to be among the better authorities. But I look at those councils; going back to that point about inspections over the last decade, we have improved local government’s capacity quite a lot, there are very few councils that are significantly underperforming, but they are doing reasonably well.

I would hope this is a sector that has got the basics in place, and that is preparing to be quite innovative and to step up to the mark. If I am wrong about that then clearly the system we are putting in place relies on councils being able to drive improvement themselves from within. If they cannot do that it probably will not work very well, and that is worrying in the sense that, if you are a good localist, if we cannot make self-regulation work, there will be huge pressure on Central Government to step back in. There is a risk here, and the risk is that local government is not quite as mature and as good as we think it is, but I do think it is good, and I do think it is mature, and I hope and expect that they will step up.

Q187 Simon Danczuk: I wanted to follow on from some of the things that have been said; if scrutiny committees are a qualitative technique for getting to the crux of what is going on in services, then the place survey, as part of CAA, is probably a quantitative technique for finding out what the public actually think in a sophisticated and robust statistical way. That has been thrown out with CAA. Is that a good thing or a bad thing? Before you answer that Ben, you have practical experience, because last week we had councillors from the LGA and different sections of it coming in and telling us that, in terms of benchmarking, local authorities would do it voluntarily because they would be shamed into it if they did not provide the data to compare to other local authorities in a similar family; they would be shamed into doing it and they would not dare not provide the data to benchmark. Your company does benchmark data, or survey data as it happens. Could you share your experience of local authorities and how keen they are to be named in terms of being benchmarked against other authorities, or not?

Q188 Simon Danczuk: My other question is around audits. How will auditor independence be safeguarded if local authorities appoint their own auditors? I know that, Simon, your organisation has been doing some research around it, is that right?

i on Parker: We have, I think it comes out in the next week or two.

Q189 Simon Danczuk: Any headline results are helpful at this stage.

i on Parker: In terms of the question you have just asked, I have talked about the idea of semi-independent audit committees with councillors, but also residents and others, involved. We think you should have an audit committee which is actually appointing the auditor of the local authority, rather than the local authority just choosing whoever it wants. That is our proposal for safeguarding the independence of the process. I can tell you about a couple of the other things we have thought about if that is useful. The key thing that we have looked at is: at first glance the move to devolve power over
audit looks like deregulation. It is really localisation of regulation, and we think you then have to reinvent a new regulatory environment on the ground. That is one of the reasons why we think the independent panels to appoint auditors are very important. We also think we need a rule that internal auditors and consultants cannot also be external auditors. That is really to answer the Enron problem.

In terms of accountability and independence we are gearing up to make those two recommendations. There is also a point about the cost of audits: it is not obvious that getting rid of that huge monopsony buying power of the Audit Commission will result in cheaper audits, in fact quite the opposite, particularly for smaller or remote authorities. We think the only way that you will actually guarantee lower prices is to make sure that it is a very competitive audit market. One way that you could achieve that is to support the Audit Commission’s mutualisation into the fifth of the new Big Five: we think, on balance, that would probably be quite an effective way to control cost.

We also think you need to simplify local government accounts, because at the moment the complexity of those accounts is a barrier to smaller players entering the market. Equally we have to accept that we are not just trying to localise the old audit regime. That is a really important point to make here: the audit regime would have had to change anyway. In a world of localism, the Big Society, councils are going to start risking a bit more of their money out in voluntary and community groups, they are going to start doing things like sharing services, so we will need simpler, smarter sorts of audit as part of all of this.

I would add to the point I made earlier about audit committees not being completely separated from the scrutiny function. The function of scrutinising is very much something that audit committees do, and so in looking at the totality of how an authority is challenged at local level, it should be considered together. The research that we did a couple of years ago found that the audit functions had found a benefit in being more closely connected to the other scrutiny bodies in the council, not least raising the profile of it with members and getting it taken seriously as a form of governance that can be seen as a bit dry and not relevant to the day-to-day.

There are benefits to having some connections, but we would agree that it should be independently chaired, either by the opposition or by an independent co-opted member from outwith the council. Another mechanism that could be looked at is the code of practice, which provides the independent professional framework within which auditors work, which is something they would point to as guaranteeing their independence: having their own professional standards to work to. That should be looked at, particularly in the light of all the other changes that we have been talking about to the governance regime, perhaps to require more attention to be paid to the kind of governance aspects of what appears in the accounts.

There is an annual governance statement, and we have been looking at them, and a number of them are highly variable in who writes them, what purpose they perform. For some of them it clearly is integrated in the way that the authority makes its decisions and so you have some confidence that there is some consideration given to risk and governance as part of the overall framework. In others, it is a little bit perfunctory; it is a list of who does what. There are other aspects of the regime that could be strengthened to support governance overall, which will be important if there is no longer this external framework that has been provided by the Audit Commission.

Q90 George Hollingbery: Simon you have just gone some way to answering my question about the costs. It seems that you are of the opinion that costs may well rise per audit?

i on Parker: The impact will be variable, because at the moment the Audit Commission bundles together clusters of authorities and gives them out as a package. It would vary: if you are a big authority that is relatively easy to audit you may see your costs fall, if you are small and more remote then you will be less attractive and you might see your costs rise.

Q91 George Hollingbery: The Audit Commission, in their submission, talked about the 1,200 parishes who get audit for free at the moment potentially ending up in real trouble, ending up having to pay, and maybe paying disproportionate amounts to get any kind of reply at all. Is there place for a small companies account-type return, do you think, in this whole scheme?

i on Parker: We would very much hope so, and that is one of the ways to introduce a bit more competition into the market. That is one of the reasons why one of the most important recommendations that we are currently considering—of course, we have not finalised anything yet—is that point about simplifying the accounts, so it is a bit easier for people to come in and do them without having to spend a lot of money to enter the market in the first place.

Q92 George Hollingbery: I am suggesting that there is perhaps a role for a return that is not audited, that can be viewed online, as there is for small companies. Is that a realistic proposition in this area?

i on Parker: Gosh, that is a good question. It certainly sounds feasible for parishes, but I would need to consider it further before giving you a full answer.

Q93 George Hollingbery: Another point that the Audit Commission made, which I thought was fascinating, was they took on the liability from the auditors, which is not something I considered before and I suspect is worth a very great deal of money in terms of the price you negotiate with the auditors. Is that something that your group has considered at all?

i on Parker: I do not think it is particularly.

Q94 George Hollingbery: It does occur to me, and perhaps the others would like to comment, that there is a very considerable saving probably made, because this is laid off on Government. Effectively it is very difficult to sue Government for this, I suspect, hence why the Audit Commission was allowed to do it. Do
you think there is a possibility that that will up prices, that there will be a considerable factor in there?

en Pa e: I am not an expert in audit costs, risks or litigation, etc.

Q195 George Hollingbery: Perhaps I will go back to the Audit Commission on that one later. CIPFA: I think you have already touched on the complexity of the front end of accounts, which I find completely impenetrable. As somebody with an MBA and specialisation in accounting in the commercial sector, I find CIPFA's accounts completely impenetrable, particularly trying to relate them to what is going on behind in the council. Do you think there is a role there for some reform? Second, I am very interested with the Localism Bill going through, and with commissioning rearing its head, how do we audit all that lot sitting behind?

en Pa e: On just publishing financial data about authorities, CIPFA has done some good work itself in the past, in the last two decades, in giving prizes to authorities who use graphics and other things to try and make clear where the money has gone, but it is not about changing the format of the accounts, it is about producing literature, websites, etc, that visualise it much better for people. You are clearly along the right lines in terms of the need to make this more transparent, but at the same time we need to be realistic about the number of people who are going to look at it. For those actively involved, or who are the activists—the minority of the population—undoubtedly, there is a lot more that can be done, because there is a lot that people miss.

Q196 George Hollingbery: Commissioning, anybody?

essi a ro e: It is something that is going to be increasingly important. It is something that we have argued in relation to scrutiny, and the same principles would apply that there should be more of a level playing field. It should be something that should be considered now with the possibilities not only of commissioning, but of joint-commissioning, of pooled budgets across areas. This goes right back up into the higher reaches of Whitehall, because it is about funding streams, where they come from, who makes the decision, who voted the money down, for what purposes. Pooling spending decisions and commissioning decisions at local level creates some complexity, but it then reaches back up into Whitehall as well. There is a job of work to be done in looking at this; it would be quite nice if there could be a common audit regime across the public sector.

Q197 George Hollingbery: In short, this is a pretty complicated addition, which we had not really seen before, certainly not to any great scale.

i on Parker: Yes, and what will happen when community groups take over services using Right to Bid, how do we audit shared services? There are no easy answers, but we clearly need to be able to come up with some way to capture that money.

Q198 George Hollingbery: One final question for Ben, you might not want to answer this in a public forum, but, if you could give us a ballpark as a Committee privately perhaps, we are interested in the cost of data gathering, roughly how much does something like this cost?

en Pa e: To be honest, I cannot remember. It depends how you collect the data. This one was done by telephone, 500 interviews with senior people, it will be £20,000 to £30,000, I do not know. In looking at all of these things, the cost of data gathering in terms of finding out what the consumers of the service think about it, as a percentage of the cost, should be tiny. Of course those things need to be looked at; it needs to be proportionate. The main thing about gathering survey data is it needs to be in a form such that people can actually use it, and it should not be too often, because it takes time for organisations to act on it, but it does also need to be reliable. To be honest, that does cost some money.

Q199 Mark Pawsey: In addition to the question of cost in a post Audit Commission era, what about that of capacity? Every local authority has the same year end; if you take away the Audit Commission does the capacity exist within the Big Four, or other accountancy professions, to get audit done on time?

en Pa e: I think you would have to ask them, but I somehow think that capitalism will deliver the goods.

Q200 Heidi Alexander: Armchair auditors: what role do you think they have, if any, in monitoring the financial performance of councils as well as service delivery?

en Pa e: In theory, vast. In practice, successive Governments, both Conservative and Labour, have worked on the basis that if you publish the data, be it on posters, in newspapers or online, residents will read the data, and when they see malfeasance, or inefficiency they will rise up, with pitchforks and flaming torches, and come to the town halls and demand change. The evidence has been for Governments of all complexions that whether you publish performance information in the local newspaper, you put it online, most people do not. That is not saying that you should not do it, but you need to have realistic expectations about the number of people who are going to find it fascinating and interesting. It has been one of those fantasies of successive Governments that there will be huge public appetite for this data and use of it. It may be that things have finally changed and the internet has changed everything, but I have not seen it yet.

essi a ro e: I would agree with that. The key thing is, if somebody does have a concern—and I agree with Ben that there are not going to be that many of them who really delve into it in detail—they need to have a way to do something with that, because publishing and being transparent is good and is a necessary thing, but it is not sufficient to deliver real accountability. If somebody is worried about something that has been published, being an armchair auditor, what do they do with that concern? We would say one of the things they should be able to do is to take it to their local councillor and get it looked into by scrutiny, because you also need to be able to make
judgments about not only what was spent but the value of that money. *en Pa e:* Much more needs to be done to make sure that information is transparent and understandable by “ordinary people”, because one of the issues is a good 10% of people in this country do not understand percentages, and the way in which people have often in the past got round this obligation to publish—which you can see in some ways with some of the demands for complete transparency of everything now—is to produce it, but in such a form that people cannot effectively use it.

*i on Parker:* Data is not information. At the moment what we are chucking out is loads of data. I am the sort of person who might be an armchair auditor; I have spent quite a lot of time looking at open data websites. I am astonished both by the sheer amount of data that is available now and how little you can easily do with it. A lot of it is practically worthless; I could not even work out on one council’s website how much the chief exec was paid. There is a real question about how we make sure this is turned into something people can do something with, and if I cannot do something with it—you know, On the other hand, when it comes to the armchair auditors, there is a danger that we assume that if we do not have this army of armchair auditors crawling over the accounts then the approach is worthless, and I do not agree. I think you need a few of them, because for me the point is not so much everyone is crawling over the accounts, it is that when you take a decision as a council you know someone might check it, and you have to think “What would happen if someone saw this up on a screen, and if they would not think it is good do I really want to do it?” It is that shift in mentality that is the most important part of the reform.

*essi a ro e:* That is a really big challenge to the way lots of people have thought about how decisions are made, and how Government is carried out. I think of Leo McGarry, who was quoting Bismarck in *West Wing* where he said, “Law and sausage are two things you do not want to see being made”. This is turning that completely on its head and saying that people do want to know how things are done and made, and there is a question mark as to how many people want to know that, but having the right to find out if they want to, and it being able to be understood, and people having the knowledge that somebody might ask those questions, are important. It is the mechanisms that exist to say, I am unhappy about it, what can I do?

Q201 Mr Betts: Finally, there are not that many Doncasters around, but is there a danger under the new arrangements we will get more, and is there a danger that, if they do happen, they will be less well dealt with?

*essi a ro e:* I do not know whether I should declare my interest as a Government appointed commissioner in Doncaster at the moment. I have intimate dealings with them. There must be a question as to: would those very serious service failure cases be picked up, and the mechanisms exist to do something about them? I think that is a fundamental challenge and question. I do not think it is necessarily the case that it is more likely there will be more of them, but there has got to be a question about picking up on them, picking up on them early and having the practical mechanisms of intervention.

*en Pa e:* I would just post one question for political parties, because you could argue that local government has been inspected, weighed and measured more and more over the last two decades, and, in a sense, it has probably—some people would debate it—become more competent, but nobody has ever checked the sanity of the captain, the locally elected politician. That is not to be done by any central inspectorate or by Central Government, but it is up to political parties, and some of the failures, you could argue, are about the inspection regime, but they are often about what is going on inside local political parties and how the parties police themselves. When I think of one particular local authority, which is in Wales, it is partly because there are no political parties doing anything much there, it is just strange personalities.

*essi a ro e:* It often is to do with personalities, that is the trouble, because it is not something you can put your finger on and define: it is personalities.

*i on Parker:* We clearly need a failure regime. We need a way to spot failure early on, and a way to decisively tackle that, and we will see if self-regulation has the teeth to do it. To reflect on the Doncaster case, I am not sure it is the Doncasters we need to worry about so much over the next two years. Yes, those organisations happen where there is huge corporate failure, but I suspect they are few and far between these days. There is a more worrying question about how a lot of authorities will react to the spending cuts, particularly some smaller authorities taking big cuts may well find themselves facing something that looks like technical insolvency. How do we cope with that? We need that question answered pretty urgently I think, because it will almost certainly happen somewhere.

*en Pa e:* We did a piece of work for urich Municipal where we were interviewing senior people from across the sector, both inside local government and in the auditing community. It is widely thought that one of the risks of the scale and the speed of the cuts that we have is that some authorities will simply fall over and there will be service failure. How is that dealt with if that happens? It is a risk of this process of fiscal consolidation, as the Treasury likes to call it.

*essi a ro e:* The intelligence gathering that is available to the sector should not just be left to the local government group; they have got a leading role to play, but it is all the bodies with an interest in having effective local public services coming together collectively in some way, without the coordinating role of the Commission, to say, “What do we know about organisations?”, whether it is political failure, whether it is financial failure, whether it is service failure, and pooling that information.

Q202 Mr Betts: Who would do that coordinating without the Commission?

*en Pa e:* Good question.
We have said things about them. We will, of course, notice more of the times when we have been quite willing to be very critical of Central Government when necessary, but local government have been too much simply a mechanism for Central Government to do what it thinks and therefore of itself has not been that independent, and therefore local government has probably not been as supportive of you as it might have been in some other circumstances. Do you think that is a fair criticism, or do you think there are perhaps other reasons why your demise has been brought up on you?

Mi ael Hi ins: I do not think that is a fair criticism. I can understand where it comes from. By statute and practice we obviously have to do the things that Government and Parliament ask us to do. Democratically elected local authorities do not necessarily want that central scrutiny, but democratically elected Parliament and Government has a right to ask for it to be done, and we have to respond to that. I have always liked to use the phrase that we are equi-close to local government and Central Government, but we are quite willing to be critical. There was the headline once of “watchdog bites master”, and we have, on a number of occasions, bitten Central Government quite hard. Most recently, for example, we did a report on children’s trusts, Are we there yet?, that criticised the confusing guidance issued by Government around that issue, and said that they were successful despite Central Government, rather than because of it. In Tired of hanging around we criticised the multiple funding streams applying to youth services pointing out that some youth workers spent 13% of their time applying for grants for the next phase of work. We have been quite willing to be very critical of Central Government when necessary, but local government will, of course, notice more of the times when we have said things about them.

Examination of Witnesses

Witnesses: Michael Higgins, Chairman, Audit Commission, and Eugene Sullivan, Chief Executive, Audit Commission, gave evidence.

Q204 Mr Betts: Good afternoon, thank you for coming. This is the third evidence session of our Inquiry into the audit inspection of local authorities. Just for the sake of our records could you just indentify yourselves, say who you are, and the organisation you represent?

Mi ael Hi ins: I am Michael O’Higgins. I am Chairman of the Audit Commission, and this is Eugene Sullivan, Chief Executive of the Commission.

Q205 Mr Betts: Right. Thank you very much for coming. The Audit Commission has had a number of aspects of criticism made of it. One of them is that it has been too much simply a mechanism for Central Government to do what it thinks and therefore of itself has not been that independent, and therefore local government has probably not been as supportive of you as it might have been in some other circumstances. Do you think that is a fair criticism, or do you think there are perhaps other reasons why your demise has been brought up on you?

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Q206 Mr Betts: So why your demise then, if that is not the reason?

Mi ael Hi ins: It is a decision that the Secretary of State will doubtless explain to you when he gives evidence. We were not consulted about it. We have to get on with organising for it.

Q207 Mr Betts: So there was no consultation going on with you about how things might be altered before the decision was announced?

Mi ael Hi ins: The Secretary of State announced that he wished to abolish CAA quite early on, and we stopped work on CAA the week he made that announcement; we did not wait to receive the letter several weeks later from CLG. In respect of the abolition there was absolutely no consultation in advance.

Q208 Simon Danczuk: It is a question that I touched upon with the previous witnesses, and it is simply: what safeguards should be put in place to ensure auditor independence, if local authorities are commissioning their own auditors?

Mi ael Hi ins: The independence of public auditors has been established since 1864, and was reinforced as recently as the turn of the century by Lord Sharman and agreed. It is worth quite a lot of consideration and thought before overturning a principle that has established for that long. Do you want to answer more directly Eugene?

ene llivan: We have been working closely with the Department for Communities and Local Government on the design of the audit policy, and what we see in consultation when you debate the independent appointment versus appointing their own auditors is that, whichever side of the fence you come on that, everybody says there must be stringent safeguards. It is the design of those safeguards that is very important at the moment, and that is still a work in progress. There will be work undertaken by the Financial Reporting Council, by the Audit Inspection Unit, there will be some oversight by the C A G—the Comptroller and Auditor General, sorry—and how all of that looks against the status quo will be an interesting evaluation and impact assessment. I have to say, at the moment our instincts are that the whole will be less than the sum of the parts.
Q209 Simon Danczuk: Okay. Winding forward in terms of the Big Society, and lots more organisations, social enterprises, operating at a local level and delivering services, etc, how easy will it be for audit to take place? Will it be radically different from what is going on now?

Mi ael Hi ins: There will be difficulties, because the nature of the regime allows us to react to some of the issues around joint commissioning and shared services, because we appoint auditors across the piece, and have tried to appoint the same auditor to a local authority and the PCT. If the local authority and the PCT try to do a joint initiative we can very easily deal with that. Whichever organisations are doing it in the future will have to develop a degree of flexibility around the regime, and the barriers to entry into the local audit market are underestimated.

As has been said, the local authority audit is very complex, perhaps an unnecessarily complex issue—I cannot understand them either—and there are not many firms that would be able to enter that market. There are not many firms that will have the capability to enter that market. If we look at what has happened with foundation trusts, which were given the freedom to choose their own auditors a number of years ago, at that time there were about six auditors of the trusts that have since become foundation trusts. That is now down to three, including us, effectively.

ene llivan: If I can just add, the previous session touched on the policy changes that are going across the whole of the regime, with GP consortia, changes in police, elected police commissioners. That is a lot of change to the sector, and then changing the regime of auditing that sector at the same time is a bold move.

Q210 George Hollingbery: Can I just challenge you on this independence issue? Just because something has been the same since 1864 is not a particularly good reason, I have to say. The private sector seems to get away perfectly adequately with having people who are being audited appointing the auditors, and, okay, it is a different world, I understand that there is public money involved, and so on, but we do live in a very different world than we even lived in 15 or 20 years ago: accessibility of information, the transparency of process, the availability of newspaper reports to people at the touch of a button. It seems to me that there are a lot of reasons to think that that world might have moved on. Justify for me, if you will, why the public sector is unique and has to have independence of audit?

Mi ael Hi ins: I am not saying that because something has existed since 1864 it should not change, but some reflection about the replacement structure is in order. It is public money and that does create a significant difference because if I am being forced to pay taxes in my local authority I may want to know that the people appointed to look at the spending of those taxes have not been appointed by the people doing the spending, that there is an element of independence in that appointment. In the private sector—my background and Eugene’s were in professional services in the private sector for quarter of a century—we have seen examples of overly-cosy relationships. Now, one can build in safeguards against that, but as a local elector it is of interest to me to know that the auditor is appointed independently, and has the capacity to be critical of the local authority.

Q211 George Hollingbery: How is this any different to BP or Shell or one of the very large businesses out there?

Mi ael Hi ins: It has to be critical without that affecting whether or not they are going to be reappointed. If there is a real failure in your authority that I am concerned about as a district auditor, and I know that the audit tender is up for contract next year, am I going to be as publicly critical? We have had instances at the Commission where we have been asked by authorities to change their auditor because the auditor wanted to be quite critical. We can refuse. It may be a little harder in a different context. Eugene?

ene llivan: As the Chairman says, public money is different, and there have been well-established principles of public audit. There are three: one is the independence, the other is the wider scope of the audit beyond just the true and fair opinion, and the third is public reporting. Some of those aspects of wider scope and public reporting take us into quasi-judicial areas. The scope and arrangements for public audit have been established for a long time. Now they are being changed for one bit of the public sector, and not only does that mean that bodies will be allowed to appoint their own auditors, and their tax raising bodies will be allowed to do that, which is unusual, but it is for a unique special set of it, not the whole of the public sector. We are going down a Companies Act regime, and there has been no real debate as to whether that regime is a suitable alternative for public money, at a time when people think companies’ audit regimes need to be more like a regulated regime, like for the public sector, to bring and hold people to account.

In fairness to the question, there is a debate to be had about whether that is a breach of the principle too far—for some it would be—or whether it is not a breach so long as you have the safeguards. We would respect that debate has to happen through the consultation process, through the legislative process, but anyone who takes the view that it can happen wants the stringent safeguards—all commentators say that—and they need to be in place.

Q212 George Hollingbery: Is there anywhere else in the world where this is the case; where it has gone private, as it were, where you can appoint your own auditors in the public sector?

ene llivan: Not that I know of in public money. In saying that I am perhaps thinking more of the sort of Commonwealth-type regimes, if you like, that would have borrowed from here. They are the ones that I perhaps know best. I would not pretend to know—

Q213 George Hollingbery: So set around with that qualification?

ene llivan: Yes.
Q214 Mr Betts: Would it be possible to give us some more information on that?

Mi ael Hi ins: We would be happy to give you a note on that.

Q215 Bob Blackman: In your evidence you allude to the fact that you think that the wide range of audit activities that you are undertaking was of value, but we have heard evidence to the contrary from the LGA, local authorities, etc. How would you defend the position of this wide range of activity that you are undertaking?

Mi ael Hi ins: The study that Cardiff University did on CPA inspection activity indicated that 84% of senior local government officers believe that the CPA had contributed significantly to improvement in local government. Three years ago Sir Peter Gershon, in his study, said, “There is no hiding place because of CPA. CPA has shown you can improve services even while making efficiencies.” There is external evidence to support the fact that the other things we did had value. That is not to say they should not change, in fact, in changing from CPA to CAA we were already recognising that the CPA regime had run its course, as all inspection regimes do, and tried to move to a regime that looked at place rather than at organisations. Whether, given more time, it would have proved more fruitful is speculation at this stage.

Q216 Bob Blackman: Many people would say auditing is about checking that the books balance and it has all been spent properly, but you went into value-for-money studies, a much wider aspect of auditing. We had evidence from your former Managing Director of Communications that most of your auditors were not properly trained in value for money, did not really understand what they were looking for. Were they adding real value?

Mi ael Hi ins: The individual in question worked for us for a relatively short period of time; I do not accept what he said. The different functions we were asked to do came as a result of Government—indeed, Governments of different parties—expanding our remit or amending our remit. Had the current Government thought that our remit needed to be narrowed they could have done so, and narrowed it down to a pure audit remit had they wished. We are used to having our remit moved up and down.  

ene lliwan: If I may, some of the previous sessions have moved between the assessment and inspection roles that we had, and the audit role, and they have been more strident about the assessment and inspection than they have about the audit. I accept that some have questioned the scope of the audit and the fees that go with that. We are dealing with those things around trying to reduce the fees to the end users, but there is a general acceptance—I think the Secretary of State has said himself—that the audit has always been a strong line. The scope of the audit is a matter of political choice and policy choice that can be talked through in the design of the new framework. I do not think it is necessarily wedded to where it currently is, but the opinion, the value for money, governance, and the regularity or the legality of expenditure, and how it is expended: all of those are key principles that are encompassed in our audit.

Q217 Bob Blackman: You have provided us with some evidence of your costs, and the activities, which have reduced over the past three years—I think it is fair to say—but that starts from what would seem to be quite a high base. How would you justify that high base in terms of the value for money you are providing for Government both locally and centrally?

Mi ael Hi ins: One of the perpetual features of any efficiency programme is that it invites the question: that means you must have been inefficient beforehand. We know that the best companies in the world continually strive to become more efficient and think of new ways of doing things. We have changed our accommodation strategy: we reduced our space used at Millbank, our headquarters, by a third, saving over £111 million as a consequence. That is partly because we have taken advantage of technology to create different working patterns, with people working away from the office more and therefore needing less office space. We have also changed the nature of the audit that is carried out, partly in response to the abolition of CPA; we have simplified the audit that has been carried out so that it is not as burdensome on audited bodies.

ene lliwan: It is fair to say that about £30 million to £35 million of that saving is as a direct result of stopping doing CPA and inspection. In many senses 70% of the objectives of the abolition are achieved just in that one policy area.

Q218 Bob Blackman: What would your estimate be of the public saving of the CAA inspection?

ene lliwan: Of the CAA inspection?

Q219 Bob Blackman: Obviously it cost £35 million. What did it save?

ene lliwan: For the public at large? That is difficult to quantify, and especially for CPA, which only existed for one year. We have seen estimates for how much it cost, but I could not put a figure on how much it has saved.

Mi ael Hi ins: Local public service expenditure is around £200 billion; that is the total amount that we audit. A 1% efficiency improvement across that would more than pay for the costs of the Commission over its lifetime.

Q220 Bob Blackman: Sorry, you are saying it cost £35 billion to undertake.

Mi ael Hi ins: You are asking for the impact: I am saying it is hard to quantify, but if it were as little as 1% that would be worth £2 billion.

Q221 Bob Blackman: But you do not have evidence of what you have saved the public purse?

Mi ael Hi ins: No, because that is down to individual local authority decisions.

ene lliwan: We are familiar with the Comptroller at the National Audit Office, who do keep savings on those sorts of things. We have always fought shy of that, because we regard the improvement that follows from the work as being
undertaken by the authorities themselves, and we would never wish to taint that by scoring and claiming credit for that.

Q222 Bob Blackman: Finally from me, there was a major press report yesterday about the costs and expenses at the top of the Audit Commission. How would you respond to that press article? I am more interested in giving you the opportunity to set the record straight, if you wish to do so, because this is obviously a public forum.

Mi ael Hi ins: I greatly appreciate the opportunity to comment on some of the deeply unpleasant things that have been said about us over the last seven months. To abolish us is fine: that is a decision that the Secretary of State can entirely properly make. There have been some misleading stories, and the weekend was misleading as well. To take but one example, the so-called transport allowance that the Chief Executive, and, indeed, most professional staff in the Audit Commission, receive is a company car allowance, which some people choose to take as cash. They get it provided they still have a car available for use on Commission business. The story over the weekend was totally misleading.

Q223 Bob Blackman: Okay, would you like to go any further than that? The other piece in the article was about the salary levels, and obviously the Secretary of State had intervened, in the appointment to the Chief Executive role, on the specific issues of salary levels. Would you like to comment on that?

Mi ael Hi ins: The Secretary of State’s intervention is well known, but the Secretary of State should not be blamed for the salary levels, because the Audit Commission Act provides that terms and conditions of employment are a matter for the Board of the Commission to decide on. The Chief Executive was initially asked to do the job on an interim basis pending the appointment of a new Chief Executive, and agreed to do so while commuting from his home in Yorkshire. In the circumstances that developed with the Secretary of State declining to agree a new Chief Executive, and then a month or two later announcing our abolition, which would make it very hard to find an external candidate to come in and manage the demise, the Chief Executive kindly agreed to continue the role pending our demise, which, at the time, we thought was going to be earlier than it now is.

In consequence he still has to commute from his family home. I am sure many of you will know that coming down, spending three nights a week in London, staying away from your families, is not all the fun it is cracked up to be.

Q224 Bob Blackman: Yes. I will not delve into the expenses issues that apply, but you can understand how MPs will be very sensitive on this particular issue at this particular time. Given that you are recipients of substantial sums of public money, how widespread is this within the Audit Commission in terms of these allowances that are given? This would be helpful to have on the public record from everyone’s perspective.

Mi ael Hi ins: Staff of the Commission that have to travel on business are allowed to claim those expenses, and if they have to overnight they will claim the costs of overnighting, as other people in public service and in the private sector would do. The limits are quite tightly controlled; the hotel limit for London has now been reduced from £160 to £120, to reflect the new circumstances, and it is only when there is a business need that people do so. We do use video conferencing quite significantly—that is one element of our efficiency programme—but as a national organisation, there are times when people will have to come together to meet, and that necessarily incurs the sort of costs that inevitably will hit newspaper headlines.

Q225 Bob Blackman: And how have you changed the expenses regime, let us say, over the last three years? How has that been reduced?

Mi ael Hi ins: We have made it less generous.

Q226 Bob Blackman: And is it on the basis of receipts produced, or is it an allowance of money to be given?

ene llivan: As Mike said, we have reduced all of our allowances for hotels, we have set ceiling tariffs for those. We have reduced meal allowances. We do not pay any day subsistence or anything like that, and our whole policy is no profit, no loss. We reimburse what people incur, but everything has to be receipted. Most of it is procured through contracting arrangements, Expotels and travel companies, and also, for the record, the Chief Executive’s expenses are on exactly the same basis as every other member of staff, with the same limits, so there are no exceptions.

Mi ael Hi ins: Our expenses are published on our website. They have been for several years, and if you look you will see that mine include tube and bus fares rather than taxi fares a lot of the time.

Q227 Heidi Alexander: Can I just ask you about the work that the Audit Commission did, and probably still does for however long you continue to exist, on national value-for-money studies. I just wonder if you have any views on who should take on that area of work?

Mi ael Hi ins: The value-for-money studies programme cost us around about £5 million a year; that is reducing now as we reduce the programme, as people are leaving the Commission. For that we did perhaps a dozen major studies every year that had significant impact on aspects of public policy. So our study on ageing, n t s t e n, changed DWP policy in respect of what they did on that, which is really important for a large number of people in this country. The hope has been expressed that other organisations could pick up and do the studies, and certainly some of the work could be done by think tanks, etc. It raises two questions: first, who is going to pay for it? If the NAO or think tanks do it somebody is going to have to pay for it. Second, will they have the independence to be willing to be extremely critical of the people who pay for the study, ultimately? We can
be critical, both of local government and Central Government, and have been. That may be harder for other people who are less securely funded that we were to do.

Q228 Heidi Alexander: Some reference has been made about the possibly the NAO taking over this area of work, do you have any views on that?

Mi ael Hi ins: It would require some change in NAO policy, because we have an explicit duty to scrutinise Government policy, not just the process of policy being carried out, the NAO does not, and traditionally has not done this, so that would need to change. It could clearly do so. That would simply mean that some of our costs would transfer to the NAO rather than being saved.

Q229 Heidi Alexander: My final question on this area: with new models of service delivery—I have sat on the Localism Bill for the last couple of weeks, and particularly looked at the community right to challenge, and potentially different bodies providing services more widely across the country—I just wonder, from your national value for money work, whether you foresee that area as being interesting in terms of local authority value for money going forward?

Mi ael Hi ins: It certainly can be, because there are areas where community bodies can do things faster, more flexibly, more responsibly. One of the questions I would have about it is: who is going to identify the really good examples of good practice and spread them? It is very important that other bodies in other parts of the country have an opportunity to see what is happening and learn from it. One of the things that happened when the CAA results were published was that, I think in Sunderland, the leader took to the cabinet members the list of nearby authorities who were doing very well in areas that were Sunderland priorities, and said, “We should try and learn from these.” That is an element that may be missed unless there is some bringing together of information and of evaluation.

Q230 George Hollingbery: You were both in the audience earlier when I was drilling down on the parishes, and so on. If you do not mind I will come back with a couple more things. But first of all, regarding these unaudited or currently audited-for-free bodies, the 1,200 parishes you have identified in your evidence, is there room for a small companies type audit, do you think, where the amount of spending is so small that just a return will do? I will just load the auditors carrying out their quasi-judicial functions in relation to it, not any issues about competence, and we do not know yet how that will be dealt with and how they will price for that, and the abilities of local authorities to procure and negotiate that. We can get you a more detailed paper and an estimate for that.

Q232 George Hollingbery: Just very quickly, can you also find us the answer to: do you think the level of claims is lower, because you represent a very large Government institution, or the Government as a whole, and therefore people are less inclined to come at you? Perhaps it is something for the paper; perhaps you can make an estimate of it?

ene llivan: I am tempted to give you an intuitive answer, but I will take some time and give you a careful answer.

Mi ael Hi ins: I would say that our ability to stand behind auditors is quite important in reducing resistance, because the people that the auditors are scrutinising know that they cannot get the auditor to back off by challenging them with legal fees or other concerns. In the very long running Westminster saga 20 years ago, the fact that we were standing behind the district auditor was one of the reasons why that was able to be brought to a successful conclusion.

Q233 George Hollingbery: Okay, and back to the parishes? ene llivan: Back to the parishes. Peter Lacey from the National Association of Local Councils was here the session before last, and he made it very clear that they had the biggest population with the smallest fees and were quite concerned, because that regime works well for them. They get a limited assurance service that is quite cost effective; some of the bodies do not pay anything at all, and for others it is as small as £50 an audit. Our recommendation is: the best way would be to find a way to transfer that capability and keep it intact, and maintain that, and that would probably be best for the sector itself. A second best option would be to go down the small companies audit and put together a regime around that, and we are quite happy; we are working, again, to input the ideas to the Department around how that might work. Our preferred recommendation would be the former.

Q234 George Hollingbery: CIPFA: there were some whys smiles earlier about the complexity of CIPFA accounts.

ene llivan: I think CIPFA can talk for the complexity of their accounts. Accounts are complex, even the small bodies have got some quite complex transactions, but there is no doubt that they could be more consistent, and there is a need to look at the accounting framework. There is also a need to look at the accounting timetable, because it is all too lax around when they have to be published and when they have to be audited by. As you move forward on accountability for public money, you may need a tighter timetable, as well as a tighter accounting framework.

Q235 George Hollingbery: We have talked a little about the changing role of Government.
Commissioning councils: let’s take Suffolk. You guys must have been thinking about what was going to happen as people commissioned more and more services, and how you would audit it. Do you have any feel or estimate as to how much extra it would have cost? How much would the auditors have tried to charge you for doing this more complex work, this work at a further remove?

Mi ael Hi ins: I am sorry, there was some rustling of papers.

Q236 George Hollingbery: Essentially, because there are now many more bodies through which money is funnelled, it is going to be that much more complex for auditors to follow trails. Do you have any estimates internally, had you remained in place, as to how much more that would have cost, and therefore what you might have been willing to pay for it?

Mi ael Hi ins: We have quite sophisticated modelling for our medium-term financial plan around the fees for different types of bodies, and we can reconfigure that around what might be the difference between a PCT and a GP consortium. We have not factored in what might be the complexity of auditing across different bodies and the community type bodies, not least of all because we are not going to be here.

Q237 George Hollingbery: Will that particular element of it be more expensive? Let me ask you that.

Mi ael Hi ins: Probably.

Q238 George Hollingbery: Generally are there any examples we can look to overseas? Can you evidence whether you think it is going to be more or less expensive as it is being proposed by Government?

Mi ael Hi ins: Sorry, the commissioning or generally?

Q239 George Hollingbery: The whole regime. Will it cost more to audit local government? Let’s just keep it down to plain auditing at the moment.

Mi ael Hi ins: Absolutely, I will do that. At the moment, for a FTSE 100 or 250 company with a turnover between £5 million and £6 million, the average fee is £623,000. The average auditing fee for a local authority with similar expenditure levels is £236,000, which is less than half. We believe this is partly down to the bulk procurement that we do. We made major savings when we negotiated a new contract with audit firms in 2006 07, and when we offered to extend that contract for a further a three years without competition they gave us a further significant discount, £21 million, which has been passed on to audited bodies.

You may remember that Sir Philip Green, in his recommendations four months ago about Central Government procurement, said that Central Government needed to use its bulk purchasing power more. We represent the bulk purchasing power of local public service audit. I think there will be increases in fees. There is quietly likely, if the foundation trust example is followed, to be a diminution in the number of people providing the services, and I think you will also get an increasing disparity of fees. Birmingham City Council or Westminster will find it easy enough to get auditors at competitive rates, but if you are a district council in a far-flung part of the country your fees might rise significantly, or you might find it quite hard to get people who are interested in auditing you.

Q240 George Hollingbery: So your recommendation to Government would be, if we are going to go, replicate at least that feature of us, somehow?

Mi ael Hi ins: I think some form of central procurement makes sense for a range of reasons, including that.

Q241 Simon Danczuk: What progress have you made with arrangements for the audit practice of the Commission?

Mi ael Hi ins: We have done, first of all, some internal restructuring, to position the audit practice as a single managed entity throughout the business, and we are putting in place arrangements from 1 April for them to operate more like a company to help get the disciplines that they will need. Again, we are working closely with the Department for Communities and Local Government for the options for transfer of the 70% of work that is done by the in-house audit practice, and what arrangements there will be to compete that work, and to externalise it, and the role of the in-house audit practice in that. There are various options that are being discussed. The Secretary of State will receive a full paper of the options and some professional advice on the valuations and the econometrics of those options with a view to taking a decision probably April May.

Q242 Mr Betts: Can you tell us what the options are?

Mi ael Hi ins: There are probably three options that are being given serious consideration: one is a straight outsourcing option, where we would run a market test and compete the work, and do it under a transfer of undertakings. That has the attraction of certainty and mitigating the potential liabilities around the in-house practice. Another model is to set up a commission or a Government owned company to get the practice match fit to compete on a level playing field. That will take a little bit longer, it carries more risk around redundancy, but it would mean the market had a distinctive choice, it would have the ability for continuity, the in-house practice would have had the opportunity that it has been promised, and you may then create value which we would get a capital receipt from. Those are the two main options.

Q243 Simon Danczuk: What is the third option?

Mi ael Hi ins: The third option is a successor body, a residuary body, retains something, it does the commissioning and managing of the market, and even the regulation if the passage and consultation on legislation says the regulation arrangements are not rigorous enough. You could retain a residuary commissioning body.

Mi ael Hi ins: That sort of residuary body would cost about £4 million per year we estimate. It
could be organised to give local authorities a choice of auditor within a framework of auditors selected by a central procurement, so it would achieve most of the Government’s aims, and it could, of course, be run largely by local government under powers from Central Government.

Q244 Simon Danczuk: Of those three options do any of them include the Rochdale option, which is a cooperative, a mutual? Is that a possibility, that has been talked about has it not?

Mi ael Hi ins: The second and third options would both allow that. Can I make one comment about the first option that Eugene outlined: a straightforward outsourcing seems an easy thing to do, it has been done a lot in local government in other areas. The problem is that for us to outsource the 70% of the market that the audit practice does to private firms in a competition would take something like 18 to 20 months under EU procurement law from the time it is announced. During that time our senior and very effective audit staff might decide that rather than us deciding to where they are going to be outsourced, they would individually choose which company they wanted to work for—I would if I were them—and negotiate their own deals. That would mean we would have to continue the function that we have, while a very significant portion of our staff would be moving.

Q245 Mr Betts: Are there different costs in terms of redundancy payments and pensions for the different options? If so can you give us a feel for them?

Mi ael Hi ins: We estimate that the redundancy costs that we are inevitably going to face would be £40 million as a minimum. We have paid out £27 million already. In addition, that redundancy bill could rise to something of the order of £105 million at the top, if we had to make redundant all members of the audit practice. The outcome is likely to be somewhere between £40 million and £105 million, hopefully at the lower end, because many of them will transfer to audit firms, or, if the mutual is successful, will stay with the mutual. There are potential pension liabilities, but we believe that they need not be crystallised. There are ways in which the Government can act so as not to crystallise those pension liabilities. There are some estate costs where we will not be able to get out of the leases in time.

ene llivan: About £15 million on that.

Mi ael Hi ins: About £15 million.

Q246 Simon Danczuk: The Secretary of State said that your abolition would save £50 million, is that not right? Have I got that right? Do you not think that is the case?

Mi ael Hi ins: The only figure we can find that corresponds to that is our corporate costs. Our total corporate costs are around that number, but they include the costs of supporting the audit practice, so those costs will continue in some guise or other. The costs that we think might be saved would be up to £5 million from our studies function, assuming the studies function is not transferred elsewhere, and up to another £5 million from our regulation and quality assurance functions. Some of those costs may transfer elsewhere: for example, the FRC or the NAO may incur some costs in doing so, so it is up to £10 million annually that will be saved, less whatever costs are transferred elsewhere rather than abolished.

Q247 Mr Betts: This is just on the audit side; we are not considering the CAA?

Mi ael Hi ins: The CAA was obviously abolished before the announcement about the abolition of the Commission, so that can be done separately, but the abolition of the Commission itself, post-CAA, saving up to £10 million a year, depending what costs are transferred elsewhere.

Q248 Mr Betts: You said the pensions liabilities need not be crystallised, does that mean the Government has to find extra money to do that?

Mi ael Hi ins: It is partly because of the way in which pension liabilities are calculated if you are a going concern or not a going concern. As a going concern we are something like 99.5 % funded, unusually, for our pensions. If we are deemed to cease to be a going concern we would have to crystallise liabilities of several hundred pounds. However, if the Government takes our pension fund onto its books and undertakes to pay the liabilities that are due then there is not a crystallisation. Equally, if it gives a guarantee we do not have to crystallise it and can continue treating it as if it were a going concern.

Q249 Mr Betts: And because you are fully funded there is no need to put any money in, so as long as it continues that guarantee—

Mi ael Hi ins: Exactly.

Q250 David Heyes: You will have heard our previous witnesses being very sceptical about the role and value of armchair auditors. The Secretary of State wants to create an army of them. You have had firsthand experience, I guess, of what would now be described as armchair auditors, members of the public raising issues with you. What have you learned from that experience?

Mi ael Hi ins: If Mike Freer were here he would tell you that an objector cost Barnet Council well over £1 million a few years ago.

Q251 Mr Betts: He has told us already.

Mi ael Hi ins: I thought he might have done. I think it is one of the balances in a democracy, to what extent you allow objections, and who the person is who could filter objections and say, “That is a reasonable one to pursue,” “That is not a reasonable one to pursue,” or “That is excessive”. The transparency that the Government seeks is an important virtue. The Audit Commission exists to promote transparency, so we believe in transparency, but as previous witnesses have said, data requires context to become information. It is not much use knowing that your organisation spends £597 on paper each year if you do not know what the paper is used for, or what other organisations spend, so you need some benchmarking, and hence you need an ability not just to know what your authority is spending, but
what others are spending, and what outcomes they are achieving with that spending.

Armchair auditors pose a question: will the data give them context so that a well informed citizen can understand what is happening? Secondly, there is the issue around the amount of additional work that would be created in responding to the queries of armchair auditors. The transparency is good, but we will need to find ways to make data self explanatory for people.

Q252 David Heyes: I can make a shrewd guess about who my local armchair auditors might be, and the phrase “Every village has one” might be appropriate. They do tend to write to you in green ink. They can be very harmful, as you have said. Should we be looking to limit what individuals can do in terms of challenging the accounts?

Mi ail Hi ins: I think we have previously suggested to CLG, and it is part of this exercise to suggest, that the ability to object be amended, and it may simply be that the district auditor gets a power to deal with objections. Even if, at the moment, the district auditor takes two days to look through an objection and see whether it has substance to be worth examining further, that is probably £5,000 worth of costs. Even a relatively simple thing has costs, so you will need to consider where the balance of democracy and costs lies on this.

Q253 James Morris: On the question of CAA and CPA, were they not solutions which were cooked up in the centralising minds of Government, had a demotivating impact on local government, and did not really have very much impact on a resident’s sense of what services were being delivered at what quality?

Mi ail Hi ins: I would accept the final point that they did not have much impact on residents’ sense of services, although when we introduced comprehensive area assessments the website was getting a couple of hundred thousand hits a month from people who were interested in that. What CPA did, certainly in its early guises, was shock some authorities. We have examples in Waltham Forest, in Plymouth, in Coventry where they simply did not realise that they were going to get as bad an assessment as they did, and the shock led to changes. Leaders sometimes changed, chief executives sometimes changed, policies changed, and even under the short-lived CAA regime there were occasions when we were discussing areas in which they might be getting a red flag on a particular issue, for example, cooperation between health and local government. The threat of a red flag actually unblocked areas of non-cooperation that they themselves had not been able to unblock before that. You may think that is sad, but the unblocking took that to do it, but it did have explicit impacts like that.

Q254 James Morris: Were you not just a delivery arm, in essence? The way an audit inspection and the Audit Commission built up over time, it developed its own bureaucracy, it became a delivery arm of Central Government, totally anathema to giving local authorities more latitude and more freedom to do what they wanted to do; you were just there to ensure that Central Government could keep its tight grip on them.

Mi ail Hi ins: Before Eugene answers on that, can I state that on a number of speeches I said to local government “When Central Government issues guidance, remember it is guidance.” If it is going to be mandatory ask them to make it mandatory, but if it is guidance you have the right to ignore it. I think local government sometimes took guidance to be more than guidance, and needed to be more robust in its own response. Eugene?

ene llivan: I do not think we were delivery, because we were not delivering a particular programme; what we were doing was doing an independent objective assessment at the Government’s request. The important thing there was to make sure it was robust, it was consistent, it was free from challenge.

Q255 James Morris: As the lady in the previous session suggested, did your framework not just encourage that kind of game playing among officers of local authorities, which was not really directly relevant to the quality of the delivery of services, it was more to do with career protection, to do with just conforming to the tick boxes that you were putting in front of them?

Mi ail Hi ins: Some gaming undoubtedly happened, but that is the nature of any regime, which is why I said earlier that regimes need to change on a regular basis. But there is no doubt that both the first cohort of CPA from 2002, and the refresh from 2005, had significant and substantive impacts, as well as making people think “How can I learn the rules of this and get round the rules better?” That was one of the reasons we moved from CPA to CAA, which did not have the same need for “This combination of results to get this score”.

ene llivan: If I may, CAA was distintively different, in one respect quite ambitious around the fact of focusing on local priorities and local outcomes, and not so much giving a scored assessment for the area but identifying good and not good practice, and not so much giving a scored assessment for the authority. But it was implemented well, and people learn from both types. Green and red flags were a benefit to all people who learned from those examples. So it had potential, it was different, and it was not formulaic.

Q256 James Morris: Is there a danger that it had the effect of dragging some people up, but also of stifling the most innovative and dragging them down?

Mi ail Hi ins: I do not think so. One of the things that we looked at and were curious about was why the best performing authorities were the ones that seemed to get even better rather faster than the worst. The answer is fairly obvious if you’ve been in the business; good organisations tend to have cultures that are well-led and want to get even better. So the organisations that wanted to be innovative were more than capable of being innovative in whatever regime we defined, and if you look at some of the best performers under CPA they were the ones who were consistently innovating.
Q257 Mr Betts: A couple of points: first of all, benchmarking. You obviously spend quite a lot of your time collecting and analysing performance data, doing comparative studies. The local government group is saying that this actually could now be done by a local government family, and using data that they are probably collecting anyway. Do you think they can do it as effectively and on a basis that is less open to challenge as consistently?

Mael Hi ins: It is a basic principle of any information strategy that the information used to carry out business activities at one level should be the same information that is used by management and those who are monitoring what is happening at a higher level, but simply at a different level of aggregation. It should be the same information whether it is the local government group or whether it is the Audit Commission. The information that is being used should not be information that is collected specifically for the purpose, it should be information that is required for the regular management of an organisation.

We have always been very clear that, if they are using different information than the information we require, then either we require the wrong information or they are not using the information they need to run their organisation. With that caveat, the local government group could indeed carry out this sort of work. The question of a member-based organisation that previous witnesses have raised is relevant: a number of authorities have left the LGA, a number of others have given notice of their intention to leave. Quite where they would fit in some sort of sector-led benchmarking is an open question, and if you think you are about to get a bad outcome from a benchmark exercise, do you decline to provide the information and leave the organisation? Protocols would need to be developed around things like that to ensure it does work.

ene llivan: I have been invited on to an advisory board for the LGG around self improvement, self regulation, so I have bit more insight there, but it is quite early days yet. The last session covered in quite some detail self improvement and self regulation as two separate things, and the local government family is absolutely right for sector-led self improvement, but once you get into regulation, when you talk about sanctions and maybe throwing somebody out of the member body, you are into a different ballgame in regulation. And I think they called it right, about the need for somebody independent, whether the Centre for Public Scrutiny or whoever, to give a bit more grit in the oyster around what could look like just a family looking after its own behind closed doors. Because transparency to that process is going to be very important.

Q258 Mr Betts: Coming on to perhaps more serious issues, as I raised with our previous witnesses, the issue of cases like Doncaster; hopefully there are few of them, and fewer than there maybe historically have been. Do you think that any new regime can effectively cope with the Doncaster situations in a timely and effective way?

Mael Hi ins: I think there are two aspects to the new regime that need to be looked at: firstly, what is the mechanism for intervention? Secondly, and prior to that, what is the information and who gathers the information that would indicate a need for intervention.

Q259 Mr Betts: Hopefully the bell will stop in a second. Just finish your answer.

Mael Hi ins: The two things, the intervention and the information that would trigger the intervention. One of the advantages of the current regime is that, because there is a district auditor, and district auditor staff in every locality, we already have an access to soft information about things going wrong. A centrally run intervention system will not necessarily have that soft information, so you need to consider how you would gather the information that local people or local auditors might have available and feed it into some mechanism that triggers intervention.

Q260 Mr Betts: So it is about spotting things before they go further.

Mael Hi ins: Ideally. Doncaster was a long-running saga, but all our intervention was because we had a public interest report two years previously to which we judged that their answer was unsatisfactory and that was part of the reason we took the further intervention.

Q261 Mr Betts: Okay. Well, thank you very much indeed for the evidence you have given to us. We almost concluded it without the intervention, but thank you very much indeed.
Monday 21 March 2011

Members present:

Mr Clive Betts (Chair)
Bob Blackman
Simon Danczuk
Mike Freer
Mark Pawsey
Steve Rotheram

Examination of Witnesses

Witnesses: Dai Hudd, Deputy General Secretary, Prospect, and Chris Round, Audit Commission Branch Chair, Prospect, gave evidence.

Q262 Chair: Good afternoon, and welcome to our fourth evidence session on the inquiry into the audit and inspection of local authorities. For the sake of our records, could you introduce yourselves, and say who you are and the organisation you represent? Dai Hudd: Thank you. I am Dai Hudd, Deputy General Secretary of Prospect.

ris o nd: I am Chris Round; I am Branch Chairman of the Audit Commission branch of Prospect.

Q263 Chair: I would just say sorry at the beginning for the fact that we have slightly fewer members than we normally have. We have something quite important going on in the House this afternoon, and obviously some members have found it necessary to be there rather than here.

There has been a lot of speculation about why the Government made the decision to abolish the Audit Commission. What do you think were the true reasons?

Dai Hudd: Can I open and then I am sure Chris will add some personal perspectives as an employee of the Audit Commission? The announcement on Friday 13 August took us all by surprise. Clearly the Audit Commission, for reasons of what it does, occasionally gets into the public domain, but the announcement of the abolition came as a complete surprise to staff. As to the reasons given—that it would save £50 million of public expenditure—none of the staff were clear where that figure came from or what it was based on. As far as we can see, there has been no thought as to the consequences of abolishing the Audit Commission, and staff are still very much left in limbo wondering what is going to happen to them, and as yet no firm decisions have been made.

Q264 Chair: In terms of the savings, have you done any analysis of what you think the savings will be? ris o nd: We do not know where the Secretary of State got his figure of £50 million from. It appears to be based on the corporate expenditure, the centrally directed expenditure of the Audit Commission, but that would not all be saved if the Audit Commission is abolished, because some of that would relate to the running of the audit practice. In addition to that, a lot of that expenditure would have been saved anyway, as a result of the abolition of the Comprehensive Area Assessment. Where those figures came from, I do not know. The Chairman of the Audit Commission in previous evidence estimated that the net savings might be no more than £10 million. I have no better figures than those. The Audit Commission would have the more accurate figures, I believe.

Q265 Mark Pawsey: The Government did speak about a more localist agenda and allowing councils and authorities to get on with things. When that happens and there is no Audit Commission to monitor what they are doing, what do you think the major loss will be? How will people recognise a difference?

Dai Hudd: Can I answer that and then perhaps Chris can supplement that as well? A lot of talk in political circles has been about the Total Place and, I have to say, in terms of a taxpayer and as a union official, I can see the logic in that. If you look at Wales and Scotland, they have been able to take a broader view of public services. We think the Audit Commission and some of the work they have been doing in auditing across various parts of the public function could be the facility of developing that concept, so that localism becomes stronger, not weaker. We think part of the problem is, without a common perspective across all functions of the public sector that the Audit Commission would provide, it would
Chris, whether you have any comments.

ris o nd: I think that if the local authorities were given the power to appoint their own auditors, there is a danger that that independence would be lost. If we go back to some of the major cases, would a private sector company or an auditor appointed under contract, knowing that that contract could be terminated, be so willing to challenge an authority in the way that the Audit Commission now can? I personally do not think so.

Dai H dd: If I can just add a supplementary point, the politics of this need to be understood as well. It is fairly clear that different local authorities made up of different political complexions quite rightly will have different sets of priority. That is part of a modern, mature, democratic society. However, how public money is spent has to be calibrated, I believe, so that the public can judge beyond politics whether or not it is getting a fair bang for its buck. Without the role of organisations like the Audit Commission, any form of comparison as to public worth in terms of services, across a potentially wider range of providers in the future than we have now, needs to be underpinning that, I believe, as part of that process.

Q266 Mark Pawsey: You are suggesting that individual bodies could not decide the level of audit and inspection that they themselves should undergo.

ris o nd: I am sure that most bodies, given the choice, would want to reduce the level of the audit to a minimum, but this is public money; it is not like a private firm, where you have the choice to invest. We all have to pay our council tax to our local authorities or our taxes to central Government, which funds a lot of the local services we have. This is not a matter of choice, and public sector audit is fundamentally different from auditing a private company.

Q267 Mark Pawsey: In terms of the role that Audit Commission staff have been undertaking, has it been their assessment that the role they have been undertaking has been a fundamental and important role within the Government sector?

ris o nd: We certainly believe that.

Q268 Simon Danczuk: My question is around independence and whether, with the new structures that are going to be put in place, you feel that auditor independence will be threatened by the fact that they will be appointed locally. At the same time, there is that contrast with the fact that private practice audits a lot; there are different aspects of the public sector that already choose their own independent auditor. Just your thoughts on that issue, please.

ris o nd: I think we go back to the premise that this is not like auditing a private company. These are public bodies and this is public money; none of us have any say in whether we pay it or not. There is a fundamental difference there from the start. I believe firmly myself, and I believe the majority of staff in the Audit Commission believe, that the appointment of independent auditors is very important, because it does provide that independence and that ability to challenge big organisations, quite often political organisations. An independent regulator has that ability to challenge.

I think that if the local authorities were given the power to appoint their own auditors, there is a danger that that independence would be lost. If we go back to some of the major cases, would a private sector company or an auditor appointed under contract, knowing that that contract could be terminated, be so willing to challenge an authority in the way that the Audit Commission now can? I personally do not think so.

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Q269 Chair: In terms of independence, could you not put safeguards in? An authority appoints an auditor but could only appoint them for a limited period of time. You could even perhaps ensure that there were independent members on the Audit Commission that did that appointment. If the Government is going to go ahead, aren’t there certain safeguards that you can build into the system?

Dai H dd: This is the concept of rotational contracts. There are two question marks I would have over that. Firstly, that may very well mean that a good auditor that is producing good quality work may lose the contract by dint of the fact that they are not part of the rotational chain. The other difficulty with that is, if that is happening right across the country, the concept that I was referring to earlier about comparisons across local authorities, which may have very different political objectives but still underpinning that have to have the value of public money and public worth, would potentially be lost. Whilst it may have a superficial attraction, I am not quite sure in practical terms it would deliver the benefit that people think it might.

Q270 Bob Blackman: Under the old regime, something like 25% of audits were conducted by private firms anyway, under the direction, admittedly, of the Audit Commission. Many of those—I can tell you from when I was a local authority leader—had a private firm come in and do the audits. They discovered things that they thought should not have been done in particular ways that the Audit Commission had missed. It is not always true to say that the Audit Commission is doing things in exactly the right way, so why shouldn’t private firms actually be better at finding out some of the problems inherent in local authorities?

ris o nd: I am sure that quite often auditors will take over an audit and find things that the internal audit provider has missed. I do not think that is the
point. If you take again the Westminster case, the auditor that pursued that case, the district auditor John Magill, worked for Price Waterhouse. The point was that the Audit Commission provided the support and took on some of the liability for pursuing that case, and that is what I cannot see in the new regime that is proposed, whatever form it takes at the moment.

Q271 Bob Blackman: Is your case then that there should be protection for private auditors that may pursue this, rather than just the position that it has to be done by the Audit Commission?

Dai Hudd: I think your question, if I may just follow up, is one more of balance. There is a proper debate to be had about the balance and role of the private sector in this work. We have major doubts over the idea that in some way abolishing the Audit Commission would automatically open the door to greater private sector provision, but the argument about whether or not there is a sufficient mix of auditing being done under the auspices of the Audit Commission currently is a fair debate.

Q272 Chair: One question that you raised in your evidence in terms of the Audit Commission’s role is about the intelligent customer, which is an issue that a number of authorities have found very difficult. Once they have contracted everything out and then have to come to re-tender next time, they are not quite as able to formulate the tender documents with the degree of expertise that they probably had once upon a time.

Dai Hudd: I can see for some people of a particular political persuasion that a great rush towards—if I could put it this way—the private sector has attractions. I do not share their argument but I can understand why that may be. One of the great problems with that is, if you lose that expertise, your ability to manage that process and particularly manage competition—bearing in mind this market is so dominated by four very significant players—to the point that you become beholden to private sector competition, it not being a servant to the public—public good being the master—is a great danger. We think it is quite a danger in this particular area. There is an inquiry going on in the other place looking at this very issue as we speak, and this deliberation that you are considering today has been quoted in some of the evidence there.

Q273 Mike Freer: Do you not think that using more private-sector firms appointed directly by councils will actually drive down audit fees?

Dai Hudd: There is not a lot of evidence that we have seen to suggest that bringing in greater private-sector involvement will necessarily drive down costs. My view is that is a debate over which I am agnostic. I could argue neither that it will nor that it won’t. It is your colleague Mr Blackman’s point: it is the mix of the involvement of the private sector in this auditing area, albeit with the Commission having the ability to set the standard by which that happens, and the performance is a key point. Therefore you will be able to see whether the private sector can drive down the cost.

The other thing again, coming back to the Chair’s comment, that you need to be very careful of is, bearing in mind this is a potentially enormously lucrative part of work, there will be the move to loss leaders. There is a question people need to ask about the greater involvement of the private sector. There has been criticism for at least the last five or six years, by many different groups, of the dominance of the four big players in this area over the auditing world. If markets work so well, why aren’t more players entering that market? There has to be something structurally around the market of auditing that allows four pre-eminent players to dominate the market in the way that they do. I think there are great dangers to simply opening out to the private sector as a whole, but in part a greater involvement is something that we, as a union, would not necessarily oppose. In fact, there might be some merit in doing that for cross-comparison purposes.

Q274 Mike Freer: Is there not some evidence that things like Foundation Trusts and FTSE 100 companies have actually driven down audit fees, certainly in the last few years?

Dai Hudd: If you compare local authorities of the same size as equivalent FTSE companies, the audit fees in the private sector are considerably greater for the FTSE companies. The Audit Commission over the years has acted as a regulator of prices, by the very fact that it can act as a bulk purchaser, etc. With things like the Foundation Trusts, there is some evidence that the fees, where private-sector companies have won those audits, have been higher than if the Audit Commission in-house staff had won those audits.

Q275 Mike Freer: Hasn’t there been some criticism of the Audit Commission, because the fees went up in the last few years, when in fact most audit fees in the private sector went down? They were countercyclical during the recession. There was commentary, certainly in my own local authority, complaining of them going up when most private sector audit fees were going down.

Dai Hudd: There can be a confusion between the audit fees, and the audit and inspection fees. Now that the Comprehensive Area Assessment has ceased, the Audit Commission fees are reducing considerably.

Q276 Simon Danczuk: How do wages and conditions in the Audit Commission compare with those in the private sector?

Dai Hudd: When we have done surveys of our pay terms and conditions, we have normally compared

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1 Mr Nichols (see Q 389) pointed out John Magill worked for Touche Ross, which merged with Deloitte.
them against the public sector and the private financial sector. We have used companies like Hay-MSL to do these sorts of surveys, and our salaries have always been broadly comparable.

**Dai H dd:** In total reward terms, and that is including all aspects of employment, you could not argue that there is a lag, nor is there a gain, in relation to the Audit Commission and comparable private-sector practitioners.

**Simon Danczuk:** It is very similar, is it?

**Dai H dd:** Very similar, but the reward package is made up differently.

**Q277 Simon Danczuk:** Briefly on that, how is it different?

**Dai H dd:** For example, the pension regime in the Audit Commission is not similar to those in the private sector, although by and large private-sector salaries will be higher. If it would help, I am pretty sure we could probably dig out the comparative reports to let you see those. In broad terms, the total reward package is pretty similar.

**Q278 Simon Danczuk:** My second question is around people leaving the Audit Commission. Has there always been a high turnover? I presume it is high now; people are leaving. Some have been moved out and some are moving out. Has it always had a high turnover of staff or not?

**ris o nd:** No, the Audit Commission traditionally has had a very low turnover of staff, particularly on the audit side. Most people have been, for want of a better term, dedicated public sector auditors and have stayed with the organisation.

**Q279 Mark Pawsey:** I think it is Prospect’s position that the Audit Commission should be retained in its existing form. Is that right?

**Dai H dd:** I would not quite say “in its existing form”. We think there is a powerful argument for the retention of an Audit Commission. Our view is there is scope for reform. Clearly now inspection has gone, and that was very much a policy by the previous Government. That is no longer; that has an impact on the Audit Commission. There are initiatives this Government is taking around things like the Big Society, bringing a more diverse range of people and organisations into public service, so we think there is scope to reform the Audit Commission to respond to those challenges. There is the issue of the greater involvement of the private sector. Those are areas where we think there is a lot of scope for worthwhile and constructive debate and discussion. We would not argue for it in its current form.

**Q280 Mark Pawsey:** It does say on your website under “News and campaigns”, “Scapegoating public servants who have done nothing to bring about the financial deficit shows that the Government is tackling the symptoms of the deficit but not its cause.” Aren’t you just, as you would expect of a trade union, doing your best to preserve your members’ jobs?

**Dai H dd:** In broad terms, I have no difficulty with the statement you have just read out but, in the particular, we have always as an organisation engaged in the merits of the individual arguments. We have gone along with different models of ownership in public and private over the last 20 years, let alone in recent years. I do not demur for one second from that broad statement on our website, but we will always look at the merits of the argument in individual areas. The conclusion we have come to, in terms of the Audit Commission, is there is scope for reform. In fact, we have probably said that before the announcement was made in the way that it has. We just simply think this is a very blunt approach and one that is inappropriate, and may yet have unintended consequences.

**Q281 Mark Pawsey:** One form of reform is becoming a mutual. What is the view of your members of that?

**Dai H dd:** We would look at it. We would look at a mutual, provided there was a significant stakeholder involvement of the people who work in the Audit Commission. One of the difficulties with the concept of mutual is the Cabinet Office, as with another hat on quite a lot of the initiative is by Francis Maude. There is not a lot of flesh on the bones of what this mutual model may look like. On the one level, I think that is good because it allows for debate and discussion. On another level, it is tantalisingly frustrating, because we are not able to put a model forward to members that they can look at, see and engage in. In broad terms, a mutual approach that had strong stakeholder involvement of the people involved, with the reform agenda that I described earlier, we think could present a package that responds to a lot of the criticisms of the Audit Commission going forward.

**Q282 Mark Pawsey:** If there is a degree of uncertainty at the moment, are you finding staff leaving the organisation? What is the rate of staff turnover?

**ris o nd:** At the moment, the majority of staff are staying with the Audit Commission. The problem is the continued uncertainty. Until some sort of decision is made by Government as to whether it will support a mutual, that uncertainty is allowed to continue and we could lose staff. The Audit Commission did a survey of its staff to ascertain support for some form of employee-owned practice that would preserve the public-sector values that most of us hold, and there was 83% support among staff for that, so I think there is quite a lot of support among staff.

**Q283 Mark Pawsey:** If staff were to leave, where would they go? What sorts of skills do they have that would be marketable within the jobs market?

**ris o nd:** Most of them are qualified accountants with a lot of experience, so some staff would be highly marketable, I would have thought.

**Q284 Mark Pawsey:** Would there be opportunities for them in the private sector?

**ris o nd:** I imagine there would be for some, yes.

**Dai H dd:** Could I just follow that up? We have done some anecdotal surveys of our members, more in
science and engineering. I have to say, than this particular field. When people face redundancies, only one in four remain in the discipline from which they were made redundant. Most people, if they are made redundant, tend to look at broader career changes. Bearing in mind a lot of these people will be well trained and academically well qualified, the ability for them to switch careers is probably easier than it would be for people who have less of an academic background. You cannot make an assumption that this process would inevitably flood the market so that the private sector can then flourish. There is not a lot of evidence to suggest that that may happen.

**Q285 Mark Pawsey:** Does it follow then that, if the private sector takes up the work that the Audit Commission is currently doing, your fear may be that some of the people who have some skill and expertise in carrying out public-sector audit may no longer be involved in public-sector audit by the time the private sector comes to recruit?

**Dai Hudd:** That may very well be the case. For example, in teaching at the moment, even though there are cutbacks, teaching particularly of mathematics and other areas is in high demand. People may well make a complete switch of career and go into teaching mathematics, for example, something for which academically their background would well place them. What I am simply saying is you cannot make an assumption that these people bleeding into the labour market would automatically go to the nearest private-sector provider that does similar to what they do. Our evidence tends to suggest that that does not necessarily happen.

**Q286 Mark Pawsey:** If the private sector does take on this work and it is recruiting, your members would be ideally placed.

**Dai Hudd:** Providing you have the activity happening simultaneously, which may well happen, and people know what their options are, which they may know naturally. The announcement was made on 13 August, and we are now seven months down the line before we will get another meeting with the Minister. The last one was pretty dysfunctional, in the sense that the Minister was not particularly well briefed and was not able to respond to questions on pensions and so on. If the next one is that position, people will leech into the marketplace and make their own decisions. If opportunities in the private sector, if that were the route the Government were to take, are available at the time when skills become available in the marketplace, that may happen, but I strongly suspect that this has been planned so that is highly unlikely.

**Q287 Simon Danczuk:** I had a supplementary question around the idea of going to a mutual. I get the impression that you guys are supportive of that. You said that a survey of members suggested well over 80% were in favour. What as a trade union—you have loads of members in there—are you doing to try to make that happen?

**Dai Hudd:** We are in discussions, as I say, with Francis Maude and the Cabinet Office to tease out that idea from them. In fact, we have meetings coming up with the Cabinet Office Minister to try to understand more fully what this means in terms of a mutual concept. In this area, for example, there are significant liabilities, not just pensions in terms of staff. The nature of their work means, for example, the potential dangers of future litigation in the wider world are quite high.

**Q288 Simon Danczuk:** With all due respect, I get the impression you are waiting for Francis Maude to tell you what might happen in terms of a mutual. My question is about: why aren’t you being more proactive? Why do you not approach Co-operatives UK? As a trade union, loads of members there are relying on you. I do not get the impression you are doing a lot in terms of making it happen.

**Dai Hudd:** I disagree. With the greatest will in the world, before you can come up with a concept, you have to understand about where those liabilities are going to go. In essence, if the Government were to say, “Look, there are liabilities of this organisation going forward, and we will underwrite them with certain safeguards,” that opens up the opportunity to have an engagement discussion with members about what the future of the organisation might be. If you do not deal with that liability, you cannot have that constructive discussion, because the mind goes back—I understand this is a perfectly natural human reaction—“What is going to happen to my pensions? What happens if the organisation gets into a highly expensive litigation case with one of the local authorities 12 months down the line? It does not have an asset base to build up.” Remember the assets of this organisation are predominantly people. There is not a lot other than people. I disagree that we are not being proactive. We are. We are looking at a number of models ourselves now to see what might be out there, if you like, generally used. The difficulty is that a lot of the organisations where mutuals work tend to involve an awful lot of voluntary labour, low-cost, low-turnover, and they do not have the sorts of overheaded costs than an organisation like this needs to have for probity, public accountability and so on. We are looking at it. I am sorry; as it is Francis Maude and the Cabinet Office that have come up with the idea of a mutual, I think it is only right that we test them to ask what this means in practice. We are trying to have a positive engagement.

**ris o nd:** The biggest problem we have is the uncertainty. It is alright being very supportive of a mutual, but we do not know what the audit regime will be, what the costs might be and how much work a mutual might earn, etc. We do not know whether the Government is going to be supportive of it in the first instance. Until we know some of those things, we cannot take forward the concept of a mutual. If it is going to happen, some decisions need to be made urgently, while, at the moment, staff are left in limbo not knowing where they stand.

**Q289 Mark Pawsey:** Can I come back on that? Why does the Government need to be supportive? If the private-sector audit job needs to be done and there
will be private companies bidding for it, why can your people not form their own organisation and bid for that work? Why do you need to wait for the Government, to follow Simon’s point?

Dai H dd: Back to the point I was making earlier, the key point about this is liabilities. The first one is clearly going to be pensions for staff. How is staff liability going to be taken on? There are significant risks in entering the market, bearing in mind this organisation does not operate as a private company at the moment. It will be taking on some of the biggest and most sophisticated operators in the financial world. These people operate on a global basis with Governments, multinational companies and so on.

Q290 Mark Pawsey: Do you think they won’t be able to compete?

Dai H dd: What we are saying is that, at the moment, I do not believe the Audit Commission would be in a fit state to compete. I could see it happening if we could get to a position where we could agree on the liabilities that would be held and who would be accountable for them, and what model we could have for the staff having a proper stakeholder involvement in the organisation. At some point it might. The idea of pulling an organisation like the Audit Commission into that competitive world within the lifetime of this Parliament, let alone in the next 12 to 18 months, is fanciful. I do not believe it has the skills, nor could it attract them. The people they would need to attract to be able to compete openly with some of big players are costly; they would make your eyes water, and that is part of the problem. How on earth it gets to a position where it can compete is a big question.

Q291 Mark Pawsey: If it cannot compete, is it not better that it withdraws and leaves the work to the Big Four?

Dai H dd: That very much depends on whether you think the model of competition is the ideal way to drive efficiency and performance in this area. My view is an Audit Commission, refocused in the way that we have described, recognising that there is a greater role for the involvement of the private sector, which is already in that field and dealing with it, is a far better way of progressing than trying to push the Audit Commission simply into the commercial world over the time-spans that I have seen articulated by the Minister. I do not believe that is a credible proposition. Over time, it could happen.

ris o nd: We are currently the biggest providers of audit to local authorities. We have an immense wealth of expertise in the organisation.

Mark Pawsey: That is why I am so surprised you are so fearful of competition.

ris o nd: We cannot have competition; there is no regime to compete in at the moment. You cannot have competition where there is no competition. At the moment, the Audit Commission still exists and appoints its auditors. There is no competition at the moment.

Q292 Mark Pawsey: The level of expertise that you have should give you a head start.

Dai H dd: Can I be clear: expertise in auditing and inspection is one thing. What you are talking about is the ability to devise very competitive commercial contracts across a number of players. The idea that the Audit Commission can skill up in that key area, with some of the big players that it will be dealing with, is nonsensical. I do not believe that those contracts would necessarily be won on quality. They might be won on price, but not necessarily on quality. I think there will be a move and a rush to the lower end of the market, which many of the big players can underwrite. If the Audit Commission can develop those skills to be able to compete with some of the big players, I think it has the potential quality to compete. I just do not think, over the time-span of this adjustment, it can be done.

Q293 Bob Blackman: The concern I have, in what you are telling me, is that you appear to be suggesting the auditors are skilled, but it is the management that does not have the skills required to do the job that would be required if they were bidding for business and managing a company in the same way that some of the other auditing firms are at the moment. Is that your concern?

Dai H dd: It goes back to Chris’s point. If the market is defined now, and it is not—we have a long way to go before we get to that point—then the Audit Commission probably does have the skills to compete on the defined areas of the market where they currently are. The big problem will be if you open up the whole of the potential market to the private sector simultaneously with the Audit Commission bidding for that work as well. I strongly suspect the market nous of people who have been able to compete in a much more rigorous environment than this will mean that quality will not necessarily be the thing that comes up as a successful bid. I strongly suspect that some of the bigger players will be able to underwrite and underpin costs in such a way that the Audit Commission cannot nor ought to. It is that concern that I have: putting the Audit Commission in a position where it can compete will take work and reform.

Q294 Bob Blackman: At the moment, local authorities are required to produce accounts every year. They are then audited by either the Audit Commission or firms under the auspices of the Audit Commission, so I do not see how those standards will change. There will still be a requirement to produce the accounts; there will still be the requirement to audit them to the accepted standards. Regardless of whether it is the Audit Commission, a mutual, a private firm—and by the way it does not have to be one of the Big Four in these aspects, as it could be a whole range of other competitors—you seem to be pleading, and forgive me if I am wrong, for a special case for some sort of floated company to be given an unfair competitive advantage compared with the private sector. I do not think that is ever going to be able to happen.

Dai H dd: Let me go back to the question, and I think it was you who put it to me first: is there an argument for a greater involvement of the private sector in
relation to the work currently done by the Audit Commission? I think the balance is currently 70 30. We think the answer for that is yes. That is the Audit Commission as it is, but reformed to particularly be able to respond to those challenges. The next question we get to is whether or not it should be a mutual. That is a different question—an entirely different point. That is the point about whether or not it competes with and tries to exclude other private-sector providers. My argument is I think the Audit Commission is well placed to be able to respond and reform as it currently is for a greater involvement of the private sector in the future. Coming back to the mutual idea, which is a different strategy entirely—i.e. should the Audit Commission be more aggressive in relation to competing with the private sector and excluding as much of it as possible, which is a very different model from the one you and I were discussing earlier? To do that, it needs clearly to have a management regime that is probably differently configured from the one that it currently has. That is the point I am trying to make. I do not think you can conflate the two points. There is either one model of the Audit Commission, which is a facilitator of private-sector involvement and potentially trying to create more competition in the market by directly doing that, as opposed to one where it is a bigger player in the private sector, potentially excluding competition because of its potential size. I do not think those two arguments can necessarily be conflated in the way that they are one and the same. They are not.

Q295 Mike Freer: Just to drill down on one point, I would go for the more aggressive approach into the market, rather than seeking to be half in and half out of the public sector. Having sat on a number of Committees that have awarded audit contracts, if I can give you some reassurance, I do not think the private sector is as competitive as you think it is, because quite often I found that the gap of the private sector is that the skills mix on the audit team could not match the Audit Commission. You have a senior partner at several thousand pounds a day, and there may be an audit manager and normally two or three grunts at the bottom end, which is how the Big Four normally structure their audit teams. The Audit Commission is able to have a much greater blend of skills and experience. I am almost trying to say I do not think you should be afraid of competing because, on the merits of the quality of the team, you could outshine the Big Four. Is that not your experience: that your blend of skills is better than the Big Four?

ris o nd: I certainly believe so, yes. I think we generally have a higher skill mix for our audits, and I also believe we provide a very close and good service to our clients.

Mike Freer: So be brave.

Q296 Chair: Currently, you actually compete genuinely in the market for audits for Foundation Trusts, don’t you?

ris o nd: We do, yes.

Q297 Chair: You actually have the beginnings of that experience.

ris o nd: We have, yes.

Q298 Chair: One further point: if there was a mutual floated, would you want to see some restriction on the ability of the stakeholders of that mutual to be able to sell it on at a future date, namely for a significant profit for themselves?

ris o nd: The majority of staff would want to see it as an employee-owned organisation. Therefore, there would be some safeguard to ensure that it could not be sold off to another private-sector firm. I think staff would be looking for that sort of safeguard.

Q299 Chair: Thank you very much indeed for your evidence.

Dai H dd: Can I just compliment the Committee as well, if I may? I am not making a cheap point in relation to CLG or the Minister.

Chair: Compliments are always well received. Carry on.

Dai H dd: Over the weekend, I read many of the evidence papers, and found much more about the Government plans from the inquiry that you are doing than we have done through the conventional consultation process. That is sad, but nevertheless I thank you for the ability to do that. Thank you.
Examination of Witnesses

Witnesses: Belinda Wadsworth, Strategy Adviser, Local and Regional Policy, Age UK. Rebecca Veazey, Policy Officer, Women’s Resource Centre, and Matthew Sinclair, Director, The TaxPayers’ Alliance, gave evidence.

Q300 Chair: Good afternoon and welcome to the fourth evidence session of our inquiry into the audit and inspection of local authorities. Just to begin with, for the sake of our records, could you indicate who you are and the organisation you represent?

Matt e in lair: Matthew Sinclair; I am the Director of The TaxPayers’ Alliance.

elinda Wads ort: Rebecca Veazey; I am a Policy Officer for the Women’s Resource Centre.

Q301 Chair: You are all welcome. Could we just begin with a general question: what difference do you think the abolition of the Audit Commission will make to the quality of local services?

Matt e in lair: I think it will improve them. It will lead to councils being better focused on the outcomes that local publics need. I think it will lead to better value in audit and broadly be a good thing for local government performance.

elinda Wads ort: I think it will be a bad thing for frontline services. The Audit Commission played an important role in promoting the equality, particularly the Comprehensive Area Assessment provided a tool for ensuring that women’s needs and issues were taken into account in local priorities, and that outcomes and improvements had a significant impact on them.

Q302 Chair: I suppose there is a tension there in what you said between the view of the Audit Commission as trying to do something on behalf of central Government, with regard to standards and performance and doing comparisons, or whether it should be looking to a more localist agenda and assisting local authorities to perform better and get their own priorities right. Is that a fair description of the way it has been in the past and how change may be looked at for the future?

Matt e in lair: I think that the problem of the Audit Commission is that it was, as a national quango, adopting a kind of form that worked—in terms of its organisation of being a national quango—for the National Audit Office looking at central Government, and was applying that to local government. For that reason, it was a very centralising force and that was part of the problem. Instead of women’s issues being represented by that 50% of the electorate in each individual suit, it was being written through this organisation acting out national government priorities. The star system was the clearest example of that tendency coming into action.

elinda Wads ort: The work of the Audit Commission and the framework was not by any means perfect, but it provided a way of holding local authorities to account. In practice, what the WRC has found is that there is a lack of gender awareness at a local level. Many local authorities failed to meet their obligations under the Gender Equality Duty, so these things are already not being met at a local level. By having a national overview of how local authorities are performing on those issues, it is almost a form of a safeguard.

Q303 Mike Freer: Turning to the abolition of the CAA, do you not feel that the CAA was more process than outcome?

elinda Wads ort: To some degree it did produce outcomes. For women’s organisations particularly, they used it as a mechanism to almost enforce the duty to involve; they used it as a way of engaging in local decision making, and it almost empowered them to challenge the representation of women and women’s issues in local leadership.

Matt e in lair: I have spoken to so many councillors and people at councils who got good marks under the CAA, who viewed it with contempt. If you can give someone a gold star and they can resent it, then I think that says that something has gone pretty badly wrong with your system. If it gives a lever for women’s groups to get involved, I do not think that local politicians are going out of their way to ignore women’s needs. You are talking there about an issue that should have a pull and that accountability should happen through the ballot box.

One of the reasons why it might not would be that councils are chasing Audit Commission rankings instead of chasing those voter priorities. I think it displaces other forms of accountability, rather than being a pure addition to accountability. We need to be thinking about some of what was missed and what we should be trying to recreate. It should be our job to bring accountability to local government in organisations like ours. We should not hope for a shortcut through saying, “Well, listen to the CAA.” It should be, “Listen to us, because we can try to persuade voters.”

elinda Wads ort: Can I just make a point following on from what Matt said? In reality, we are seeing equalities being equated with bureaucracy, rather than being the most effective way to meet the needs of communities. The abolition of the Audit Commission and issues around the abolition of the Comprehensive Area Assessment are quite sad, because we are seeing the Public Sector Equality Duty being watered down. We are seeing that marginalised women, who deal with our women’s organisations and are involved in
their local communities, find that local authorities are not willing to engage with them in practice.

*Matt e in lair:* The best way of ensuring that people see the Equality Duty associated with bureaucracy is to have it acted out through the Audit Commission. If you have bureaucrats enforce equality, then people see that.

**Q304 Mike Freer:** Would Age UK like to get a word in?

*elinda Wads ort:* Last year we carried out some research, talking to a number of older people’s forums and organisations, and local strategic partnerships and local authority staff, into the value and impact for older people of the previous system. What our research found was that the majority of people we spoke to did feel that the previous system was particularly bureaucratic and onerous, and was very process-driven rather than outcomes-driven. However, there were a number of key lessons learnt from the system, which I feel we should make sure carry on. For example, the partnership-working approach very much needs to be built on. We did see some significant and very positive examples of where older people were very much involved in the decision making around those processes, and we would very much want to see that continue.

**Q305 Mike Freer:** In terms of if the other elements of equality and engagement fall away, as you fear, wouldn’t the equality impact assessments pick that up, in that there is a duty to engage and to be seen to engage, and take those views into account?

*e e a ea e:* As far as I know, under the new changes to the Public Sector Equality Duty, there will not be that onus on doing the equality impact assessments, or at least not publishing that out to the public, which removes a mechanism for holding local authorities to account, which is partly the objective of that decentralised auditing regime.

*elinda Wads ort:* We very much share the concern about the equalities legislation apparently seeming to be watered down and there not being such a strong recommendation on reporting around that. We would very much encourage any subsequent system to take a very strong equalities approach.

*Matt e in lair:* If you want to look at impacts you see as negative, with a group like ours we can do that. We can be on the watch for those. We can have grassroots networks that let us know when things are going wrong. We should be using our own analysis to reveal when these systems break, rather than relying upon impact assessments or the CAA to do that for us. We can do that job better and I think that is why we have to be here.

**Q306 Mark Pawsey:** The Government clearly has an agenda to do away with the centralised regulatory regime that we have had up until now. It sees a big plank of an alternative route as being transparency—making authorities publish every item of expenditure over £500, for example. The Audit Commission did bring out some performance data. How did you, particularly the campaigning bodies here, make use of that information? Was it useful? Was it helpful in your activities?

*elinda Wads ort:* We very much support the move towards transparency, and having information more publicly and freely available. We conducted a small focus group research of the Oneplace website last year, and found that the people we spoke to found it very useful indeed, easy to understand and were happy to use it. For those people we spoke to there, who are online users, it is clearly very useful and accessible. However, 60% of people over 65 have never even used the internet, so for us there is a major concern about information being only provided in an online format. We very much want to see that, as the transparency agenda goes forward, we have information produced in a number of different formats, to make it very accessible and easy to understand.

**Q307 Mark Pawsey:** Don’t you think that the fact that publishing it online would mean that newspapers will print it and that people who you would engage with would get the information through a different route?

*elinda Wads ort:* That is one-way information. That is fine to get the information, but if you then want to use the information in order to engage, you need to have access to being able to analyse it in the way that you choose to look at the services that you are looking at.

*e e a ea e:* I would say that one of the problems with publishing the data is that data are not very useful unless they are disaggregated, unless you are making them accessible and unless you are providing them with some form of context. The major objection that my organisation has with this armchair-auditing approach is that it is very reliant on the capacity, inclination and education of citizens. We are concerned that marginalised groups will not necessarily be involved.

**Q308 Mark Pawsey:** Won’t the media do that for the marginalised? Simply the fact of making it available means that other people will do the analysis.

*e e a ea e:* I think the fear is about inconsistency, about oversight.

*Matt e in lair:* Yes, it is possible that information could go out and would never be used. Councils as far back as the 1980s were required to publish publicity information. That never really had bite to raise the issue of whether those costs should be controlled until we did a report on it. In the end, that is going to happen. That is what groups like us should be doing to assist the media. The media will do it on their own; the media are very interested in this sort of information and they get apoplectic when they do not work properly, when they struggle to access them, as they did in the early days with COINS before the best tools came out to analyse it. Yes, some people who do not have the inclination to access data will not be able to access data, but still you are opening it out to a vastly wider array of groups and individuals by publishing it like this than you previously were, so you will get a greater variety of perspectives.
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Q309 Mark Pawsey: Would the people who are not able to access the data have read the reports from the Audit Commission?
  elinda Wadsworth: Possibly.
Mark Pawsey: Do you think so?
  elinda Wadsworth: Maybe. It depends how accessible they found them. As I said, the people we had spoken to, who had used the online system, had found it accessible. I agree: public information needs to be developed to be far more accessible than it is currently if the public is going to be able to hold public bodies to account in the way that this transparency agenda assumes.
Matt e in lair: I have read Audit Commission reports, and I have also read spending over £500 releases, for example—to give one example of a transparency release—and honestly I found the latter in many cases much more comprehensible. It is at least clear; it is at least functional. You have to do more analysis to get information out and get conclusions out of it, but at least you are not having analysis done for you in a fairly inscrutable way.

Q310 Mark Pawsey: Is it the view of people representing older people and women that we are going to lose something as a consequence of the lack of Audit Commission reports?
  elinda Wadsworth: I think it is more about, as we go forward, how we make public information very accessible and also very comparable from area to area. As I said before, while we are quite happy about localist principles of local solutions to local needs and local information and assessment, the public will also want to be able to compare area for area.
Mark Pawsey: With regard to women’s groups?
  ee a ee: I would say I agree with Belinda’s comments, yes.

Q311 Chair: On that point, are we really empowering groups like The TaxPayers’ Alliance rather than empowering the public, because it is true that the analysis will not have been done for the public by the Audit Commission; it will be done for the public by you, won’t it, and you do have a political axe to grind on most of these matters, don’t you?
  Matt e in lair: What is great is that we can do it, and then people who disagree with us can do it, and we can have a proper encounter between those two understandings of the information that has come out. We are breaking open a monopoly here. You do not have to think that you want our reports to be the gold standard here; no one is setting them up as that. We produce our work and we make it absolutely robust but, if people disagree or if people do not think we have made it robust, they can challenge that, and our credibility depends upon getting that right to a very high standard. We do not have the imprimatur of being a public sector body supposedly speaking for the Government or anything like that; all we have is our own credibility. We have to put that on the line and that is what we will continue to do. It does not have to be just us. All of us, all the organisations here and hundreds of others, are responsible for analysing this information and then talking to our grassroots supporters to try to find new ways of getting it out to the public. That is our job.

Q312 Chair: Some people might say that the Audit Commission or the Government Department is generally relatively neutral. An organisation like yours probably gets quoted more than any other organisation on these matters, so you have a pretty good monopoly of quotes on some of these issues, because you actually have a political point of view to address, don’t you?
  Matt e in lair: We have plenty of points of view, but I am saying that we can be disagreed with. There are plenty of resources available to organisations who disagree with us. They are not starved of cash, starved of researchers. There are plenty of people out there who can come out with both points of view. You are blowing that open by transparency to such an extent now that we will have done it by a multiplicity of organisations, and they will take different routes. Some will go the direction of saying, quite independently, that they are there just to check from as unbiased a perspective as possible on the veracity of factual claims.

I was talking to the website Full Fact, which has set itself up to do that very recently; there are plenty of organisations like that. There will be some who are saying, “We have beliefs about the best policies, and we see this evidence as supporting that.” and there will be groups that do it just because they have a particular stakeholder group that they want to try to inform. There will be all kinds of different approaches, and I think they can compete. We have a free market in policy analysis as well as in audits.

Q313 Simon Danczuk: Should future inspection activity be limited to services to vulnerable people then or scrapped altogether? What is your view?
  elinda Wadsworth: We are concerned about the scaling-back of inspection, and certainly we are very clear that inspection of the safeguarding of vulnerable people must continue.
  ee a ee: We would agree, and say that inspection of the promotion of equality and protection of vulnerable groups is most important to maintain.
  Matt e in lair: If you are looking to promote the interests of women or the elderly, the people who are best placed to do that and should do that are here. That role, of scrutiny of local government, has to be performed by civil society, who can do it genuinely independently, who can do it not with an eye to the latest directive but with an eye to looking for genuine problems. That will lead to a better performing system. That is not one that can effectively be done by an Audit Commission. It needs to be putting information out there. The audit role still needs something, because we need to know the information that is being released is in fact accurate at the start. We need to have that solid empirical foundation. That is where it should be: it should be at the audit stage, not at the performance stage.

Q314 Simon Danczuk: You do not think there should be inspection from the centre in terms of local authority services to vulnerable groups?
In particular in East Sussex, older people have been working very closely with the preceding structures, the local strategic partnership, and the local economic situation. They have been trying to ensure that older people are involved in every single decision-making panel in the county, and I also know a very good example in Wiltshire, where they have been very much involved in decision making and on scrutiny panels and very much influencing the decisions.

Q315 Simon Danczuk: You think that electors are attuned enough with the services provided by a local authority to various vulnerable groups, whether they are older people or vulnerable women or anything else, that they are able to make a judgment.

Matt e in lair: I think accountability should flow through voters and should flow through scrutiny from the third sector.

Q316 Simon Danczuk: You think that vulnerable groups can rely on a change every four years, potentially, in an election, to determine whether their services improve or not?

Matt e in lair: The purpose of a representative democracy is not just that you lay down the law once every four years, but that you have effective scrutiny in between; you have people concerned about thinking about those four years. “Every four years” is just there as a Sword of Damocles hanging over people’s heads; it is not there to be the only form of scrutiny or the only democratic function during that period. There are improvements we can make there, but ultimately I think scrutiny of performance should be done through the third sector, through civil society and through elections. I do not think it can effectively be done by the Audit Commission.

Q318 Mark Pawsey: I accept that, but that does not need the existence of the Audit Commission to take place, does it?

elinda Wads ort: It does need the existence of a performance management framework that they can be involved in.

Q319 Mark Pawsey: Nobody is saying that we are going to get rid of performance management; we are simply saying the Audit Commission is not going to do it. Authorities will continue to have that, and that information will continue to be available to organisations such as yours, so why should the abolition of the Audit Commission be necessarily a bad thing?

elinda Wads ort: We have been clear that we are looking to see the continuation of a form of performance management framework. As we said in our written submission, for us that could be locally, as opposed to nationally, defined.

Mark Pawsey: The same point to the Women’s Resource Centre.

Q317 Mark Pawsey: Could I just ask if Age UK and the Women’s Resource Centre could give us any examples of when you have looked at an Audit Commission report and used that information to call a local authority to account?

elinda Wads ort: The research that we carried out last year throws up some very good examples of where older people have been working very closely with the preceding structures, the local strategic partnership and influencing the local area agreements. In particular in East Sussex, older people have been involved in every single decision-making panel in the county, and I also know a very good example in Wiltshire, where they have been very much involved in decision making and on scrutiny panels and very much influencing the decisions.

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Mark Pawsey: The same point to the Women’s Resource Centre.

Q320 Chair: Is there not always a danger that you can get one authority that really is failing? If it is failing, its performance management might fail. If there is no oversight, it is hard luck for those disadvantaged children who are getting an awful service and may be put at risk, if they are going to have to wait for an election in three years’ time.

Matt e in lair: In some of those cases you have had existing structures and authorities have continued to fail. Those are very deep-seated problems in some local authorities. Hang on—we had the Audit Commission writing reports about authorities saying that they have been irredeemably and utterly failing for 15 years. You compose these questions of: what if there is an authority that just continues to fail where there is not a sanction of voters or where that is ineffective? You can come up with these sorts of things: “What if you are in an elevator and it is burning? You are in an impossible situation; what do you do?” Those have existed, will exist, and there are troubled authorities. We are not saying this is a panacea that solves that, but the present system does not have a panacea either. The best way of improving those has to be engaging through local structures.
If you look at the last question, all of these local groups can engage with how the council manages its performance. This is part of what we should be getting away from with the move away from the Audit Commission: to have councils setting up structures to manage their performance that reflect local priorities. All these things can come into being and they can be driven by effective councillors and councils. If you have failing councils and councillors, I do not think there is any evidence that the present system is able to really kick them out in a serious way. It can in the end say central Government needs to, as its ultimate sanction. You still need a powerful Government, in the case of absolute failure, to step in and remedy the situation. Again, if you need someone to ask for that to happen, it does not need to be the Audit Commission, because that is in the end a very political judgment. It will be made politically and made on the basis of groups demanding it. It does not need to be the political judgment. It will be made politically and made on the basis of groups demanding it. It does not need to be the Audit Commission. I do not think, in those impossible situations, the Audit Commission offers something invaluable.

Q321 Mike Freer: Just a quick one: has The TaxPayers’ Alliance done any research to show that many of the authorities that have had significant service failures have either had glowing reports and inspections, been four-star authorities or indeed been Council of the Year? Having been a former council leader, we went for Council of the Year. We were not placed to comment, but happily defer to Belinda on this one. Belinda Wadsworth: Indeed, a couple of reports very much stand out for us: n i a i s t , published in 2008; and n d e r r e s s r e , published in 2010. For those of us who work in the age sector, these are incredibly important reports that really reflect a state of play with regard to tackling challenges in an ageing population within local authorities. Reports like that will very much be missed. We feel very strongly there is very much an ongoing role for an organisation to produce similar comparable reports.

Q322 Bob Blackman: With the new transparency, you have all the information; you could interpret the data. elinda Wadsworth: We can produce similar reports. We do indeed produce a number of reports. The issue for stakeholder organisations like ours is actually about the accessibility of the information on which to base those kinds of analyses.

Q323 Bob Blackman: You are experts in dealing with older people. Why should not an organisation like Age UK do the same sort of thing, because you are experts already?

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Q325 Bob Blackman: How should you be funded to do it, if you were to do it?

elinda Wadsworth: We are ever hopeful, and it is absolutely critical for us that stakeholder organisations that do have that capacity to provide that kind of information to produce the reports have open access. It is not easy at the moment, I can tell you, so we are very much hoping that will open up.

Q326 Bob Blackman: Rebecca, in terms of your organisation, you are experts in dealing with women in various different guises, vulnerable women as well as creating greater equality. Why couldn’t you do a national report on the state of the nation, as it were? e e a e e : Capacity-wise, we are full at the moment, so realistically we would not, but our role is we are a national membership body, which supports women’s organisations up and down the UK, so our primary area is in research. We do feel that it would probably be better placed for the Government to conduct that study, and that we would be given the opportunity to feed into it.

Q327 Bob Blackman: Clearly the Government is not going to do this. That is quite clear: the Government will not do these studies in the future. So you are
saying this is a potential risk. Are you prepared to step into the breach?

**Q328 Bob Blackman:** Matthew, here is a golden opportunity.

**Matt e in lair:** We try. We do our bit. We are a small team, but we will do this. As far as funding goes, there are plenty of people who are interested in these issues. Fundraising is a challenge for organisations like ours; it is a challenge for anyone, but it is much better they are funded by people who are interested in the issues, so they become part of the public sector nexus, which gives it greater independence, ideally by a broad base. That is how you need to continue this work. Age UK is not a poor organisation. They are a substantial body and they do very large, heavyweight reports. You can improve data availability and should, but I do not think there is any reason that there is an inherent lack of capacity for policy reports in civil society.

**Q329 Chair:** Given that the Local Government Association has been talking about the work that they might do among their members to try to get some comparative data and maybe look at comparative studies of various kinds, I just wondered if any of you have talked to the LGA about whether you could act in partnership with them on some of this work.

**elinda Wadsworth:** Not directly, not yet, but we are certainly very open to working with the LGA in partnership.

**Matt e in lair:** We tend to have an adversarial relationship with the LGA, and we are quite comfortable with that.

**Chair:** It will probably not be a marriage made in heaven today then.

**Matt e in lair:** There is some stuff where, if the LGA wanted to do more of this with us, that is great. Honestly, the LGA probably is not the best organisation to do it, because they have deep problems trying to work out whom they are representing, because they are representing councils that fiercely disagree with each other. There are probably better organisations to do it than the LGA, but there are loads of them. There are loads of organisations that are interested in this; there is no shortage of people interested in local government policy questions. There is just not a shortage.

**Q330 Simon Danczuk:** There was some consensus earlier about the need to continue to do audit of local authorities, local government. My question then is about whether they can remain independent if they are appointed by the local authority itself, as opposed to something like the Audit Commission. I wondered whether you had a view on that.

**Matt e in lair:** I think that a system that can work for Tesco, BP and Vodafone can work even for Kent County Council and Birmingham, the largest of their respective types of authority. Those concerns about independence are important, which is why they are addressed by massive corporate risks to accountants who get it wrong. We have seen examples when accountants have not been sufficiently rigorous, and it has led to death for even the largest accountancy firms. There is a very heavy sanction; if it goes wrong, there is equally regulation. Regulators from the National Audit Office to PricewaterhouseCoopers are all regulated by the ICAEW, which has a very high reputation. It does not mean the system is perfect; it does not mean you do not need to be extremely hawkish about the relationship between auditor and audited, but the best way to do that is to do it once for companies. There is a very specific issue with central Government as regulator, and that is why I think the NAO is a very different case, but for local authorities I do not see any reason why we would want to do the business of regulating auditing twice. It is a big job, and I think we do it once and we get it right for corporates and for councils. There is no reason the same system cannot work for both.

**Q331 Simon Danczuk:** It is public money, isn’t it?

**Matt e in lair:** Sure, it is public money, but it is enormously important if there is a failure of financial controls at a major corporate; it is extremely important. I am the last one here to decry the importance of it being public money, but it is important with respect to whom you are accountable to, not who does your auditing. The audit just needs to be rigorous and, to the extent that we can ensure that, we need to ensure it for corporates and for councils. I think we can; I do not think that accountancy is a great failure that we would not want to let touch any other industry. That regulation is one that we can shift across from the existing private sector to local government.

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Q333 Simon Danczuk: Belinda, what is Age UK’s view?
Belinda Wadsworth: Our view very much would be about the need to continue the independence of audit, and we are not specialists in public audit, so really these are broad principles, and there is a need for audit to be regulated in order to maintain public confidence in public spending.

Q334 Chair: Welcome, both of you, to our fourth evidence session of the inquiry into audit and inspection of local authorities. For the sake of our records, could you just begin by saying who you are and the organisations you represent?
Paul Brien: I am Paul Brien, Chief Executive, Association for Public Service Excellence.
Professor Seddon: I am John Seddon from Vanguard Consulting.

Q335 Chair: You are both most welcome. Could you just tell us if you think the Audit Commission’s approach to trying to secure improvements in local government services was effective and successful?
Paul Brien: I think it was effective against the measures that were set, the priorities that were set, by Government over the last decade, in terms of showing an improvement with regards to local government. Whether those priorities that were set within that framework were the correct priorities may be a different matter but, in terms of the improvement framework that was established, towards the end of that improvement framework, 80% of authorities had achieved three- or four-star status with regards to that framework. I also believe, however, that any world-class audit and inspection service should work itself out of a job up to an optimum minimum level. There is a natural cycle that came from that, and the role might become a bit bloated, and there is less of a need for it now.
Professor Seddon: My answer is no. The good news is that there is still massive scope for improvement in local authority and housing services—massive. In the last 10 years, we have doubled our expenditure in local authorities and we have not seen improvement commensurate with that investment. The Audit Commission has been an instrument of Whitehall, coercing local authorities to comply with ideology and ideas simply, from the centre, both in the macro sense of “you must have call centres; you must have back offices; you must share services and so on” and the micro sense of “you must work to these targets; you must have these features and specifications existing in your services to tick the boxes”. I became so angry about this that I wrote a whole book of evidence in 2008 of how adherence to central specifications was driving costs up and worsening service. It is true for every service I have studied in local authorities and housing.

Q336 Chair: It does not need, of course, an Audit Commission to tell local authorities they have to share services. We perhaps have other examples of that. Just coming back, the Local Government Association you presumably are dismissing as being completely out of touch. While they are completely frustrated and fed up with the amount of bureaucracy that the audit regime now gives to them, they would also accept that, over the last 10 years or at least initially, it did kick start some genuine look at efficiency and a lot of authorities improved because that kick start was given to them. It probably went too far, and it has gone on too long, but there was an initial stage when it actually had some benefit.
Professor Seddon: I have not expressed a view on the Local Government Association at all.

Professor Seddon: I am a psychologist, and we understand this phenomenon called cognitive dissonance. If I spent an awful lot of effort and time doing something, I am unlikely to say it was of no value whatsoever. It is also true to say that I can identify chief executives of local authorities who I regard to have been target-and-star junkies—anything to get the ratings, which is not the same as improving your services. So many local politicians tell me that they find it paradoxical that apparently they have a four-star service yet their surgery is full of people driving costs up and worsening service. It is true for every service I have studied in local authorities and housing.

To go back to the point, the good news is that there is massive scope for improvement. To take one example, I know you have had evidence from Owen Buckwell, who is head of housing in Portsmouth. In Portsmouth, between them and their private-sector suppliers, they have developed a service that now gives housing tenants a repair on the day and at the time the tenant wants it. They deliver this service at half the original cost. If every housing repairs organisation did that in this land, we would save hundreds of millions of pounds. It is quite remarkable that the Audit Commission went to visit Portsmouth and downgraded them, because it could not tick the box. What I regard as an economic benchmark, they regard as not worthy and downgraded them, because they could not tick their boxes.
volume of calls than you had planned for.” He said, “Yes, how did you know?”
This is what happens everywhere; it happens in the private sector too. If you think, as the Audit Commission and people in Whitehall do, that this is just about transaction costs, “Let’s move things on to a telephone; it will be cheaper,” you make the mistake of creating more demand for your service. This is not an argument against call centres; it is an argument against focusing on cost. When you focus on cost, paradoxically you drive your costs up. As you have seen with e-sites, “Let’s move it on to the internet. That will be cheaper.” All it does is create more demand into the call centres.

Q337 Chair: We should go back to pen and paper.
Professor eddon: I have not said that.
Pa l rien: As I said in my opening remarks, I think there was the evidence of improvement against our framework. Whether the framework was right or wrong, whether there was a correlation between the framework that was there and what the public want from public services is another matter. To have an independent body established that assesses performance against that framework is important. Whether the framework from the outset was about Government priorities or the public’s priorities, and whether there was a correlation between that, is an issue, I believe.

Q338 Mark Pawsey: In addition to auditing and inspecting local authorities, a great part of the Audit Commission’s work has been to assess the value for money that an authority offers. In a future regime, how important should be an independent assessment of whether or not a public body is providing value for money? Mr O’Brien to start with.
Pa l rien: I think it is the public purse, so it is important that there is an assessment of whether value for money has been achieved. I think there is a need for openness and transparency in public services, and a need for challenge where that is failing. One of the significant issues about the role of the Audit Commission, as I said earlier, is that it was independent; it had the chance to look across the sector and join up some of the lessons that have been learnt on a national basis. I was listening to the last session, when people were talking about some of the value-for-money reports that were established. I found some of them very helpful. I found osit ely harged useful, which was the report that looked at trading and charging in local government, and identified £11 billion of charges were levied from local authorities in 2007 and 2008. The fact that only 75% of local authorities had corporate strategies towards charging was a real lesson for those 75% of local authorities. or etter, or Worse, the report that the Audit Commission did on strategic partnerships and whether they were actually delivering on the promises that were made at the outset, was another piece of important work. One of the things I would want to raise is, if it is other organisations that are delivering those types of reports in future, will they have a vested interest in the outcomes from those reports or will they be as independent as the Audit Commission was?

Q339 Mark Pawsey: You think there is a big issue with regard to independence if people other than the Audit Commission prepare these reports?
Pa l rien: What I am saying is whoever does those reports would need to be independent. There is no point in an organisation doing that if they have a huge consultancy ring that operates alongside them, and they have a vested interest from that.

Q340 Mark Pawsey: There needs to be a body other than one that is providing—
Pa l rien: There needs to be an independent body, yes.

Q341 Mark Pawsey: Do you think that the transparency, the publishing of all items of expenditure over £500, will go a long way towards providing an assessment of value for money for the armchair auditors?
Pa l rien: My view of the armchair auditor is that they will not want to work their way through volumes of items over £500. They will probably be interested to know that the average cost per household to get their bin emptied is £64 per annum; the average cost to keep their street clean is £35 per annum; the average cost to maintain a streetlight is something like £48 per annum. They may be interested in those types of things. I do not know how far beyond those types of things, I do not think they want to plough through tomes of paperwork to get to those issues.

Q342 Mark Pawsey: Professor Seddon, you think the value-for-money reports were of less value than Mr O’Brien does?
Professor eddon: There is a big problem with value for money. The problem is a problem of operational definition. Value for money is a thing we would all like. It sounds great, doesn’t it? It is a bit like leadership; it is a bit like intelligence. It depends what you mean by it and, therefore, what you choose to measure. When you read the value-for-money reports, there are implicitly a whole series of definitions of what is value for money, and many of them are problematic. For example, in November 2005, the Audit Commission published a report in the value-for-money series. I can quote it: “The greatest potential for efficiency savings in housing benefits will be partnership working.” That is not true. They actually encouraged in that report all London boroughs to outsource their back offices for housing benefits to low-cost areas of the country, where we can buy cheap labour and have independent contractors do it, and then pay them on a transaction-cost basis. This has locked in massive costs. The truth is that the most optimal way to design a housing benefit service is not to have a front office back office, and no back office whatsoever. The optimal way to design a housing benefits service is to meet people face to face with the right expertise and solve their problems. This is happening, for example, in many local authorities. Stroud is one that has been published; East Devon is another. There are many others that have followed this route, and they have achieved 20% to 40% efficiency savings as well as
having a rise in the volume of demand because of the recent recession. More than that, they do not just solve the housing benefits problem; they solve the total problems of the people who are presenting, so we do not get demand on to other services. That is true value for money. If you follow the Audit Commission’s advice on value for money, you would end up with a high-cost, poor-quality service, as most local authorities have, because they have been obliged to follow it.

Q343 Mark Pawsey: Is that because the value-for-money report then recommends a course of action?

Professor Seddon: Indeed, the conclusion was you have to work in partnership, share your back offices or outsource them to the private sector—absurd. Hundreds of millions of pounds of public money has been spent on backlog-busting, and the backlog-busting was created by splitting the front office and the back office, and then setting targets and all the other paraphernalia, which has destroyed the benefits process.

Q344 Mark Pawsey: If we leave aside the recommendations that you are concerned about, shouldn’t somebody—at least for the reassurance of the public, who are funding everything—be doing the work that analyses what is going on and tells the public whether they are getting value for money?

Professor Seddon: No, the first thing we have to do is to get a bit smarter about what we mean by value for money. I would accept what Paul was saying; if we could actually work out that it costs £64 or whatever it is to do the average bin, that would be a more useful number than most numbers. It is actually very hard to do that in most local authorities, because of the way the accounts are run. What I am saying is that we need better understanding of what value for money means. I will give you another example: there was a recent value-for-money report on procurement in housing. Do you know, if you follow the advice of that report, you will never achieve what Portsmouth has, because it tells you that the way to buy housing services from the private sector is to buy it from the people who have the palmtops, who work to targets and who use the schedule of rates, none of which you would see in Portsmouth. Because we have frightened local authorities into professional procurement issues, they outsource their procurement now to so-called professionals, because they do not want to be sued by Connaughts and people like that of the land, so you can guarantee you are going to get lousy service provision, and we call this value for money. I have already talked about unit costs. They think that, if we move services on to the telephone or internet, it will be cheaper. No it will not, because the cost of service is end to end from a customer’s point of view. I would say, first of all, we need to get our act together about what value for money means in operational terms.

Q345 Mark Pawsey: Mr O’Brien, Professor Seddon is very critical of all the recommendations that come hand in hand with value for money. Why can’t we do what he is suggesting and simply have somebody analyse whether or not the system is working, whether it is a good system or not and leave it at that? Why do these value-for-money reports have to go into a level of detail and impose a one-size-fits-all on every authority?

Professor Seddon: I do not think they do impose a one-size-fits-all approach on every authority. Maybe people take it that way, but anything that informs what is going on, on a national basis, and identifies best practice, is useful in context to make local policy choices for elected members and senior officers within the authority. On that point about the 2005 report, John, of course that was corrected by the 2008 report, or etes or Worse, which was quite critical of the strategic partnerships. There was an opportunity to correct it, because there was an independent national body that was not afraid to admit that things had moved on, things had changed and the findings that were coming out were slightly different from what had happened previously.

Q346 Mark Pawsey: Professor Seddon has given us some examples of value-for-money recommendations that, with regard to specific authorities, were barmy. Can you give us examples of recommendations that, in your view, have worked particularly well for an authority and enabled them to create some form of improvement?

Professor Seddon: It is difficult off the top of my head, but the example I would suggest is a report I referenced, osti ely harsed, which identified the level of trading and charging activity that local authorities were undertaking, and identified the other 75% of the authorities when they did that report that did not have charging strategies in place. My information—I do not know it with me today—is that a number of authorities have then put corporate strategies in place, which have allowed them, in difficult times at present, to look at the revenues that there are through charging and see if it is appropriate to levy additional charges on certain services. Everybody has been struggling with budgets recently. The one other thing I would add is the point that I do not think it is difficult to collect how much it costs to empty a bin per annum, in a local authority. I think there are easy ways of defining that. As long as it is consistent and clear on a national basis, and people are doing it like for like, it is really easy to achieve. We do that through our own performance networks benchmarking service.

Q347 Chair: Professor Seddon, is your real problem not that the Audit Commission exists but that you are not in charge of it? Then it could do its comparisons in the way that you would like?

Professor Seddon: Very cheeky. Not at all. My purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to challenge managers to change their thinking. We, mankind, invented management; the purpose in life is to change managers to change their thinking. We, mankind, invented management; the purpose in life is to change managers to change their thinking. 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We, mankind, invented management; the purpose in life is to change managers to change their thinking.
He learned first of all from an American called W. Edwards Deming that copying without knowledge is a folly. This is what people often do. This is the way they do it. It is going on at the moment in adult care. “Oh, let’s do triage. That sounds like a good idea. It seems to be the modern thing.” It is wrong, but we copy. Copying without knowledge is a folly.

I learned from Taiichi Ohno, who built the Toyota production system, that everything you need to know to improve your service is in your own service. It is a question of knowing how to look. Benchmarking is looking in the wrong place. One of the reasons that Portsmouth was downgraded by the Audit Commission was because they did not go benchmarking. It ought to occur to at least an averagely intelligent person that you will never set an economic benchmark if you are benchmarking by visiting other people. Does that make sense to you? Some might say, like Paul, “Well, go visit them now,” but the average housing repairs manager would see things that would scare the life out of them.

Q349 Mike Freer: We accept that Professor Seddon does not like benchmarking but, Mr O’Brien, you do. How do you make benchmarking effective?

Pa l rien: You make it effective by doing something more than compiling data. You make it effective by using those data, analysing those data, assessing where you are strong, assessing where you are weak by peer comparison with others, and then you try to identify where you can improve your processes as a result of that. Evidence we have suggests that happens regularly across the country. I will be prepared to submit that to the clerk. There are probably 10 case studies or thereabout where that has led to savings somewhere in the region of £10 million. I am quite happy to submit that, but that is by learning from each other. I do not happen to think that elected members and senior officers locally and further down the line are incapable of interpreting data, analysing their processes, learning lessons from that and implementing systems and new process that actually improve the system. They are more than capable of doing that, if you give them the information and allow them to do it.
Q351 Mike Freer: Who does the auditing? Is it self-reporting?

Paulrien: The system we have in place in our benchmarking system is that peer-auditors audit us within the system from other authorities, who will go to visit those authorities, or specialists who will check the data. With our system, we do a 20% sample each year so that, within a five-year period, the full sample has been audited of the data that are in there. It is a simple arrangement. It is a random sample to assess that people are actually putting the correct figures in.

Q352 Bob Blackman: The Government’s view is that, by publishing lots more information about the cost of transactions and services, and also much more information about performance data, that will actually engage the public and the public will start to drill down. What is your view about the information that is going to be published? Do you think it is an explosion of data that will not be analysed or will it actually engage the public? Perhaps Professor Seddon could start.

Professor eddon: The requirement to publish all expenditure above £500, or something like that, is a gimmick, frankly, and an irrelevance, but it is the kind of thing that obviously appealed to somebody at some moment here. It is vital that we ask those responsible for delivering the services to make their own choices about the measures they are going to use. It is vital that we should encourage them to think about the citizen, the customer of these services, in the choice of those measures, and that those measures should be used in two ways: first of all, in the service to manage the service for improvement; and secondly, to be reported as part of the transparency agenda. There should not be additional information for reporting. It should be the same as what is actually in use.

Q353 Bob Blackman: The problem that emerges is if the local authority is making the decision over what it publishes or does not and how it publishes it, how does the citizen then say, “My authority is doing pretty well compared with the next one”? Professor eddon: I do not know about you, Mr Blackman, but I have never met anybody who spends their time comparing their local authority with another.

Q354 Bob Blackman: No, but what they may be interested in is: “I am paying this money in council tax. I am demanding a service. Am I getting the service I should be expecting for the money I am paying?”

Professor eddon: What I do find out there is that most people in our communities want local services that work, full stop. When they do not work, people do get a bit engaged, active, have a shout and go to their councillors and use the vehicles that we have established for them. What I have also found is that really interesting and something that we did not anticipate is that, where the services do work, the citizens engage more responsibly. For example, the housing minister went down to see this work in Portsmouth, and it was the housing minister who noticed how much more responsibility people are taking for their communities, for the environment, and they have a positive relationship with the council. Now that is very interesting. Because this is part of the localism agenda, it teaches us that, if we can design services that work, we will have a better impact on the communities. It is a natural phenomenon. It kind of makes sense if you think about it. That is the most important thing: people want services that work. When they work, they engage responsibly, but they do not spend an awful lot of time worrying about it.

Q355 Bob Blackman: Mr O’Brien, what is your view?

Paulrien: I agree with John that, first and foremost, they want services that work and deliver for them. However, I believe that they also want the cost of that service, the quality of that service, set in a national context as well. They want something to compare that against. My fear with the £500 issue is that there is information overload for ordinary members of the public, and the army of armchair auditors cannot get to the information that is meaningful for them. In our evidence, we submitted a small set of sample indicators that we believe the public is really interested in, like some of the ones I cited earlier about the cost of getting their bins emptied, the cost of keeping the streets clean, the cost of keeping the street lighting working. There are issues like that that I really believe the public is interested in. If that is buried within a pile of information, it would be difficult for them to find that.

Q356 Bob Blackman: Are you saying then that there should be more work done on the data that are produced so that the public can analyse it, so that it could be filtered before it arrives at the public? Is that your view?

Paulrien: I am comfortable with the notion of self-regulation for authorities, if we are moving away from what has been quite an intensive process in the last 10 years. I think everyone recognised the need to move away from that to something that was done on a much more self-regulatory basis. However, I think that has to be done on a consistent basis, and it has to be set in context. Therefore, it is important that there is probity of those data as well by someone who is independent.

Q357 Bob Blackman: Who does that? The problem from the public’s perspective, I would assume, would be that they are sitting at home saying, “Well, that is okay. The local authority has manipulated these data to make it look as good as it possibly could.”

Paulrien: That is why I think there needs to be scrutiny at a national level of data. I am not talking about what went on in the last 10 years; I am talking about there needs to be some form of light-touch overview-taking, and then, if there are significant failings in any one particular area, they need to be challenged.

Q358 Bob Blackman: The other issue that is important is if you have representation of small amounts of data. I would like Professor Seddon’s...
reaction to this. How does the citizen there spot that the local authority has just gone on a spending splurge and bought all this expensive furniture when cheaper furniture would do, or something else, because that would not be reflected in services? How do we give it teeth, Professor Seddon, so that people at home can actually say, “I am not happy with what is going on”?

Professor eddon: I have already said we ought to encourage all local authority services to be measured against the purpose from the citizen’s point of view. If we go back as an example to housing benefits, what is the purpose of housing benefits from the citizen’s point of view? It is to pay the right money to the right people as quickly as we can. Why don’t we make that a statement, and then actually tell people how long it takes from when you first put your hand up until you get sorted out? You would know that in East Devon and Stroud, for example, the ones I talked about, that you would be sorted out in three days, no problem. Done.

Q359 Bob Blackman: For you, the performance data would actually be the time taken to process the application in the first place.

Professor eddon: It is the whole end-to-end, from the citizen’s point of view. We were talking earlier about adult care. What matters to people who get into a state where they need some help from society is how quickly we go out and help them. This is the most amazing thing. If you look at the Care Quality Commission and its predecessor, the CSCI, and the same for children’s services as well, that is the single thing you do not know. We can meet all of our targets for functional assessments and activities. It means actually that the old person is visited not by one person but as many as seven different people.

Q360 Bob Blackman: Surely one of the issues is going to be under the localism agenda that services provided in one local authority could have very different performance levels compared with somewhere else. It might be that citizens say, “Actually we don’t mind.”

Professor eddon: Again, this is something that seems to have been dreamt up in this part of the world. When you go out there, you find that services ought to be different because demand is different. The demand for adult care in Bournemouth is quite different from the demand for adult care in Rochdale, Barnsley or wherever. If we encourage people to think about how we design services against the local demand, we are part of the way there to delivering services that work for people. I do not think it should be the same.

Pa l rien: I think in local government and public services there are also overarching policy drivers at times, which are not just about demand coming at you. There are things you have to show leadership on, like climate change for example, where you need to put in place certain measures, processes and systems that require leadership within an area. You cannot always do it on the basis of demand.

Q361 Bob Blackman: Can I cut across you there? In authorities I know very well, some authorities have said, “We have to capture the performance data. We have to make sure our buildings are energy efficient. We have to set leadership standards,” and that costs them relatively small amounts of money. Other local authorities went out and recruited almost an army of people to actually monitor and control and do everything possible. That is the difference, isn’t it? How do you measure it and make sure this is happening?

Pa l rien: How do you measure how effective you are in terms of climate change, for example? It is outcomes. The outcomes you get from it identify how effective you are, not how you actually measure it. I do not think you would put in an army of auditors to measure the heat efficiency of your buildings, for example, obviously as well because it is only one part of the climate change jigsaw. What is right for Cornwall, for example, on climate change in terms of solar PV use probably, because they have most sunlight hours, might not necessarily be the same for Northumberland, which might be better for wind, for example. There is a different local context to performance. There are different drivers and policy issues. It cannot always be about demand. Sometimes it is about leadership as well.

Q362 Simon Danczuk: We touched on this earlier a little bit. We had the Local Government Association in and representatives from there. They talked about replacing what has been in place with more peer review and things, and I wondered what both of you thought about that external challenge. Is it a good thing or a bad thing?

Pa l rien: It is something I would be supportive of. If you have self-regulation, it is important you have peer review to go alongside that. We will actually be meeting with the LGA this Friday to have some discussions about how we may be able to help in terms of performance management, benchmarking and that concept of peer review. It is something we believe is important: that people who actually deliver services, who understand the context of those services, who understand the policy drivers for some of those services, are actually involved in challenging at a local level how improvement can take place within those services.

Professor eddon: I would regard it as more of the same. As I have already said, I think peer review and benchmarking are the fastest ways to mediocrity. If you go in this direction, I would suggest you please do not make it mandatory. If people choose to innovate without visiting other people to be bland, encourage them to do that. I know this sounds extraordinary, but the fact of the matter is that I have had a whole life working in service organisations. If you want to change them and have a profound impact on their performance, the place to start is to go and study them, because you learn some very strong counterintuitive truths. You learn of the folly of managing costs, because managing costs drives your costs up. You learn some of the things I was talking about earlier. You learn of the folly of managing from budgets. You start to understand that, if you think about your organisation in a different way, you can achieve outstanding levels of improvement. That is
my concern with peer review, and you cannot communicate counterintuitive truths through peer reviews.

Q363 Simon Danczuk: Somebody coming in, Professor, and giving their advice and sharing their experience—I am just playing devil’s advocate here—and supposing it was you who came in and you shared your knowledge and understanding—

Professor eddon: No, I would not.

Simon Danczuk: It would not be helpful to them.

Professor eddon: No, if I was helping you and you were a manager, I would not share things with you. I would have you study some things for you to realise some counterintuitive truths. If people went to visit Owen Buckwell in Portsmouth who were housing managers, they would walk out going, “Oh, you cannot do that.” They would see, for example, that when a tradesman enters a house the tradesmen calls up and says how long he is going to be there. Most managers would say, “You cannot do that.” Why is that an important part of their design? Because they learnt that no two plumbing jobs are the same; there is variety. What is the best way for this system to absorb variety? For the plumber to decide how long he is going to be there. Now this flies in the face of convention in housing repairs, because in housing repairs, bullied by DCLG and the Audit Commission, we are supposed to use something called the schedule of rates, and the schedule of rates has a category and a code and a standard time. That will not absorb variety, so the conventional manager would look at this design in Portsmouth and they would probably say, “It is obviously pretty good but it would probably be better if they had their schedule of rates.” Instead of understanding that what Portsmouth did is study it and realise that the schedule of rates is actually driving the costs up. The best thing to do is throw it away.

Q364 Chair: You just said that you would not get people to share things or you would not share with the officers or councillors if you go into a council. You would get them to study. Actually, by getting them to study, you would be sharing what you know about the organisation you are getting them to study, wouldn’t you? You would be saying, “There is something good there. Go and study it.” You are sharing, aren’t you?

Professor eddon: That is true, but the processes are very different. One process is: “Let me explain to you, Mr Manager of a Housing Business, how you should design it.” That is rational, and you would kind of go, “No, I am sure I do not believe it.” If I said to you, “Now, study this and you will learn some things,” that change is normative. You actually change your thinking as you study what you are doing.

Pa l rien: I understand John’s theory behind studying services at a local level, and it is something I would sign up to as well. However, I do not buy the concept that for over 400 authorities throughout the UK, delivering something somewhere in the region of over 200 services to their residents, that we need to learn the lesson every single individual time, over and over again; I think we can learn from each other and I think we can generate that improvement.

Professor eddon: Our agendas are quite different. My agenda is to change management thinking and, as a psychologist, I know the fastest way to change thinking is to get them to see things they cannot see.

Pa l rien: On the point of housing repairs, for example, I could go back to the late 1990s, when people were moving away from compulsory competitive tendering and therefore moving away from the client contractor splits that were in existence at the time. In housing repairs, which is something I know about as well, there were 15 steps in the supply chain from the tenant reporting the repair until that repair was completed and signed off. By integrating the client contractor functions together, you can move that down to five steps in the delivery chain. By taking that then out to a whole range of authorities all around the UK, they were able to look at that and analyse that. I think they could make their own conclusions from that. We did not tell them how to do it on an individual basis all the time. They could understand it from how we had done it at that point.

Q365 Simon Danczuk: Just to clarify the point you made there, Professor, with all due respect you are saying your aim is to get people to change the way they do things. It is admirable, but you are a consultancy. Your primary objective is to make cash, isn’t it?

Professor eddon: No.

Simon Danczuk: It is not to make cash?

Professor eddon: No, I am a very fortunate man. Work comes to me. My purpose in life is not to make money. My purpose in life is to change management philosophy.

Q366 Simon Danczuk: I have seen the adverts in the local government press.

Professor eddon: You should have come to the event then, because the purpose of that event was to showcase not me but leaders from local authorities, from the public sector, from the voluntary sector and from the private sector, all talking about this whole business about how they have changed the way they think about management.

Q367 Mark Pawsey: I have a question about inspection, which I do not think I should put to Professor Seddon, because he has said that in every instance that he has investigated inspection, he has identified that it makes local authorities worse.

Professor eddon: That is correct.

Mark Pawsey: Mr O’Brien, you presumably believe that inspection does not make local authorities worse. You believe inspection makes them better.

Pa l rien: On a proportionate basis, yes. I do not think we need people to come in annually to tell us we are doing things wrong and this is the way you do it. I agree with John’s point about that; I do not think you need a body that does that. I think if you move to a self-regulatory approach, it is important that, as and when appropriate, when the alarm bells start to ring or an individual authority’s performance is pretty poor, then there is an opportunity to go and inspect that, find out where things are wrong and put in some corrective measures.
Q368 Mark Pawsey: Does every function of the local authority need inspecting? Are there functions that would carry on without inspection or areas that you would particularly want to focus on? Could you just clarify frequency again?

Pa l rien: It has to be proportionate to risk, I guess. Obviously if you are talking about children’s services and things like that, it is more important that there is probity around those services. We are aware of some of the horror stories that have come about in children’s services, and there needs to be the opportunity to intervene if something has gone wrong within an organisation, and attempt to put that right.

Q369 Mark Pawsey: Is inspection the only or main way to identify that, in your view?

Pa l rien: I do not think it is the only way, no. We have spoken about peer review; we have spoken about self-regulation and reporting. When that approach actually highlights issues, it is important that you can intervene in some way and set in chain a sequence of events that can generate improvement in that service, particularly when it is with vulnerable children.

Q370 Mark Pawsey: Professor Seddon, I was going to come on to your approach in that particular area, because you have said that all an authority needs to do is ask itself what means it is taking to understand and improve performance. How would that be sufficient with regard to the services of children and vulnerable adults?

Professor eddon: Profoundly so. You have obviously read the book.

Mark Pawsey: I have read the quotation.

Professor eddon: That is a start, isn’t it? First of all, given that I was just accused of wanting to make money, if I wanted to make money, I would have set up a benchmarking service; I would have set up a prepare-yourself-for-the-Audit-Commission-coming service. That is how you make money in this sector, not by encouraging people to change the way they think.

Q371 Simon Danczuk: Let me say there is nothing wrong with making money. I am a businessesperson myself, but it is on your agenda. You cannot say it is not on your agenda.

Professor eddon: No, it is not, I am very lucky. I am very busy. I earn a lot of money in the private sector. For me this is a bit of a hobby and a mission, the public sector who would not work with me, because it is too scary because the Audit Commission does not like me, because I say the things that I say.

Let’s talk about adult and children’s services because, again, I first provided evidence to the then Minister for adult care, Ivan Lewis, and David Behan, who was at that time running CSCI, saying that this is what we actually see when we study adult care as a system. I was mentioning this earlier. It is not one person who comes to see you; it can be up to seven. The financial assessment can be weeks after the process first starts and, if you had known that, you would not have bothered to first apply. You find that you waste thousands of pounds in administrative work that is completely unnecessary. You waste quite large amounts of money on material that is unnecessarily used and repeatedly used and so on but, most scarli of all, we wasted millions of pounds of taxpayers’ money driving people into care homes where they did not want to be. This was strong evidence based on studying adult care in England, in two counties, and of course it got ignored, because it did not fit the then narrative, which was about personalisation and various other dreamt-up ideas that were going to be foisted on this sector.

It is very pertinent to tell you that, in Wales, because they are not run by Westminster, we have been able to make great strides in improving the delivery of adult social care and saving the money. Millions are not being spent putting people into care homes, using equipment in an inappropriate way, and so on and so forth. This is the kind of freedom that I would expect to see. To go back to your point, if they took that question—what measures are you using to help you understand and improve for work—this is not a soft option; it is a hard option. You run a care business; you have to make those choices. I would encourage you to make those choices from the citizen’s point of view. You would need to understand the nature of demand. What do people want from us? And you need to understand how well you deliver it to them.

Q372 Mark Pawsey: How would that process prevent things going wrong? It is in this sector where, if things go wrong, most people are personally affected.

Professor eddon: I would say because it fits with the whole body of knowledge in the quality movement they call prevention, rather than inspection. We have known since the 1950s that you cannot inspect quality in. I would argue that, if you have those kinds of measures in the places where the work is done, then a lot of the current problems would not occur. The fact of the matter is, in children’s services, we have the kind of incident that we had in Haringey running at about three a week, and it is largely because of the design of the system that all the social workers have to work to. I am giving evidence to the Munro Review on this, I think it is alarming.

What is really disturbing about this is that, in England, when you get to the stage where you have all this knowledge, you see what is going wrong, you understand how we fragment this service and we do not help the children, it ought to move to a design where we are not working to all the central directives. We actually have to get a letter of dispensation from the Minister. How absurd is that?

Q373 Mark Pawsey: In the absence of inspection, how would you know that things were going wrong?

Professor eddon: Because it is palpable. It is there in the work to see, as it were. You could turn up if you wish. What I am trying to say to you is that innovation starts with having responsibility in the right place, making choices in the right place. I have no problem with citizens or other parties turning up to see what is going on. I have no problem with the transparency of the data. I have no problem with any
of that, but we have run a whole regime where the centre decides what is going to happen and then we send out the Audit Commission to coerce people to comply, and it has driven massive costs and poor-quality service.

**Q374 Chair:** Should local authorities do their own inspection then?

**Professor Seddon:** I am not a great fan of inspection because, as I have said, we have learnt since the 1950s that inspection does not improve performance. We have to change the way we think about control. It is much better to have measures that relate to the purpose of the service, used where the service is performed. It gives you much stronger control and innovation.

**Q375 Chair:** But no checks on whether that is actually happening.

**Professor Seddon:** It is a bit like that tradesman in Portsmouth, who turns up at the house and he decides how long he is going to be. If you think we should check up on him, or if you think actually what should happen—this is what does happen—is if you have a rogue tradesman who is swinging the lead, it becomes very obvious, very quickly, because the whole system is transparent.

**Paul O'Brien:** There is something I would like to say about Wales. Wales has a system in place for performance management, quite a well-established performance management framework, called Ffynnon, which is delivered by the Welsh Assembly Government, and that covers a lot of these areas and is similar to some of the things we have been talking about today—self-regulation and peer review. That is a measure of success then.

**Chair:** On that point of complete disagreement, which is probably where we began, thank you very much indeed, both of you, for a very stimulating and lively session.
Tuesday 29 March 2011

Members present:
Mr Clive Betts (Chair)
Heidi Alexander
Bob Blackman
Simon Danczuk
David Heyes
James Morris
Mark Pawsey

Examination of Witnesses

Witnesses: Nigel Johnson, Assurance and Advisory Partner, Deloitte, Gervase MacGregor, Head of Advisory Services, BDO LLP, and Rakesh Shaunak, Principal, MHA, gave evidence

Q376 Chair: Good morning. Welcome to you all to the fifth evidence session of the Committee for the Inquiry into the Audit and Inspection of Local Authorities. For the sake of our records could you just introduce yourselves and say which organisation you represent.

Nigel Johnson: Thank you. I am Nigel Johnson, I am from Deloitte.

Gervase MacGregor: I am Gervase MacGregor, from BDO LLP.

Rakesh Shaunak: I am Rakesh Shaunak from MacIntyre Hudson, MHA.

Q377 Chair: Thank you very much for joining us this morning. We have had quite a bit of differing evidence given to us about whether there really is a difference between the audit requirements of public and private sector organisations. Do you think there is a difference and do you think the basic principles of public audit, particularly the fact that a public body should not appoint its own auditors, is important and should be maintained, or should it be altered and adjusted somewhat in line with the practice in the private sector? Who would like to start?

Nigel Johnson: I will kick off, thank you. I think there is a difference in the audit requirements for public sector bodies, in terms of the need for a review of the accountability for the use of public funds, and I think that is the principal difference between public and private sector audit. In terms of the scope of work, I think the current requirements for auditors in the public sector, certainly in the Audit Commission regime, ask you to deal with elector queries, report on value for money as well as report on the financial statements themselves. Some of those responsibilities are sensibly able to be reviewed. I think public reporting by the auditor can still play quite a strong part in how auditors engage and show visibility of their work to the public at large, but I think the audit scope currently is probably too broad, would be my view, in terms of having to deal with every single elector query, some of which can be quite vexatious and become a waste of auditor’s time and elector’s money.

Gervase MacGregor: The main difference we see is clearly between the audit of expenditure, which is traditional territory for accountants, and VFM reporting, both of which are within the current scope of the audit report. VFM reporting is not something that naturally falls within the territory of accountant auditors but obviously the audit of expenditure does. So there is a difference in scope certainly. As far as appointment is concerned, companies appoint their auditors on behalf of their shareholders and essentially what happens is that audit committees appoint those auditors. That I think over the last 20 years—certainly since I have been in practice—has been a good thing, and whatever changes take place as far as in the public sector I think need to replicate that sense of independence.

Rakesh Shaunak: I think, Chairman, if one looks at it quite radically and tries to divorce what is now to what could be there is benefit in convergence between public sector audit and private sector audit. I think fundamentally it comes off the fact that the public sector stakeholders are your taxpayers and in the private sector the reporting is to the shareholders, so arguably the public are the stakeholders within the public sector. I think their needs could be easily fulfilled by introducing intermediaries, such as community interest groups for example, for very specific studies, part of the Big Society, how does one dovetail the private and the public sector? So I think currently, as the Code of Practice is drawn, yes, it is difficult to see how one could divorce all those functions, but I think if one looks at it radically there would be benefit in converging the two.

Q378 Chair: We will come on to the scope of the audit and the public interest issues in a little while, but one of the principles of public audit has been the independence of public auditors from the organisation being audited. That has been a principle for a long time. Therefore, are you all happy to tear it up and forget about the past 150 years?

Gervase MacGregor: I certainly did not say that. I said that the independence, so far as in the private sector, the way audit committees have taken that role on from the reforms that started taking place 20 years ago, is something that needs to be maintained within the public sector. That independence is clearly very important. So it is certainly not our position that that should be torn up. How it is replaced is another matter and, in terms of having educated committees of non-execs, for example, who do the appointment, it is clearly something like that has to be replaced, it is not our suggestion at all that you tear up that degree of independence.

Rakesh Shaunak: Chairman, if I might chip in here, I think this question of independence applies equally to the private sector as well, because at the end of the
day that is a potential conflict we face all the time. I know there are our colleagues from the Institute appearing later but fundamentally independence is the foundation of the work we do. So I don’t think one necessarily need compromise its independence by being appointed by somebody else.

**i el o nson:** Can I just add, I think it is right to look at the private sector and say what creates the ability for an auditor to remain independent and potentially to be reporting without fear or favour, and I think there are mechanisms within that regime. For example, if an auditor is asked to resign by the directors, or indeed the shareholders, there are rights to write formally and have that letter reported in Annual General Meeting and that goes on public record at the company’s registrar, in terms of the statement of reasons and the auditor’s position versus perhaps the auditor’s position as presented by the directors or shareholders.

There are protections and mechanisms by which there can be openness about reasons behind an auditor being asked to resign or fired, which obviously can be in the public domain and therefore can show whether there is right or wrong in that decision. Similarly, obviously the appointment of an auditor should indeed be supervised by an appropriately qualified audit committee and again taken into public meeting for that approval. So again, it is not necessarily just the officers appointing the auditors—who they have friends in—it is generally an open appointment process.

So, with protections, with strong audit committees, with open ability to report reasons why and perhaps disagree with a resignation request, I think there can be ways in which that independence can be maintained, as indeed it is within the private sector.

**Q379 Simon Danczuk:** Can I start by asking about the pros and cons of the scope of the audit? I just wanted you to talk a little bit more about that, what do you think are the advantages and disadvantages of restricting the audit, the scope of the audit?

**i el o nson:** Sure. I commented, that at the moment I think there are I guess two key areas on which one reports positively currently: one is the true and fair view on the annual accounts; the other one is the value for money conclusion, and I think the value for money conclusion is one of the key differences with the private sector. What has been helpful in a way, because I think that could be quite a broad set of responsibilities and require a broad amount of work, is: what is the definition of the scope of work that is required to apply to reaching that conclusion, because to say, “Value for money has been achieved” at an organisation as complex as a large local authority would take quite a lot of work.

So what has been helpful is that the Audit Commission has specified the scope of work that underpins that conclusion. Therefore, there have been some boundaries set. I think in any new regime people would expect perhaps for auditors to still have a value for money responsibility, but I think again some boundaries that are set by a regulatory organisation would be useful so that there is an expectation, there is a clear brief under which the auditors should work.

The other responsibility is about public interest reporting and objections as a result of elector challenge. I have commented, as I say, that I think there have been useful powers historically. I have had ranges of experience from very well-targeted queries from electors to some very, very seriously vexatious ones and single issue ones, which should not be applied in terms of auditor’s time and also local authority cost. I think, with a more transparent agenda, access to greater amounts of information currently, all the expenditure perhaps being accessible, it is possible for those inquiries to perhaps be better directed towards the authority rather than just go through the auditor, and then perhaps for the auditor to assess how well those arrangements for handling those queries are constructed and dealt with. That could well form part of a value for money scope of work, to look at the arrangements, how elector queries in respect of expenditure or other challenge are dealt with, rather than going through the auditor.

**ervase Ma re or:** I think, Nigel, I would probably take a slightly different view as far as the VFM is concerned. I mentioned earlier the territory of auditing expenditure clearly within the usual expertise of an accountant auditor. Obviously, included within that is the audit of the system of internal controls, that any organisation, including public sector organisations, use to control expenditure, make sure it is properly authorised and things like that.

I think when it comes to VFM the expertise required there is different, is different from what accountants are used to providing. Where I do see VFM, within the scope of an accountant, is making sure that an organisation—like an authority, for example—has a control that it looks at VFM, rather than undertaking the VFM itself.

**Q380 Simon Danczuk:** Just on that, it is almost as though you are suggesting that the system should be shaped to suit the accountants that are going to do the work, as opposed to what Government might want in terms of auditing the local authority.

**ervase Ma re or:** I don’t think I am saying that at all. What I am trying to make sure is that the auditing is seen as auditing, and to the extent that value for money is undertaken. There are experts in various areas who can do that, and who can do that better than an accountant. Quite frankly, if you go to a large accounting organisation and you ask the auditors there, when the auditors do VFM they will be calling on their specialists. In my firm, for example, we have many specialists in healthcare who can very much do those aspects of VFM. I do distinguish those from what I see as the traditional territory of auditors, which is looking primarily at the audit of expenditure and looking at the system of internal controls.

I would say one other thing about VFM, it seems to me that a lot of it is based on measuring inputs—cost per whatever—rather than some of the outputs, making a separation and putting the responsibility primarily for looking at whether there is value for money on the body that is spending the money and then getting specialists, as necessary, to come in and look at that. That is a much better way of achieving that. I am certainly not suggesting that you should
stop that or that you stop looking at value for money altogether, far from it. What I am suggesting is that you look at it in a better way.

*akes a nak:* My position is that value for money should be done by specialists as well. I think internal audit has a role to play in that, whether it is an externally appointed internal auditor or the local authority’s own internal audit function, provided the controls are in place and the requirements are clearly stated, such as for example in the Code of Practice. I think the scope currently is too wide, and it ought to be focused towards expressing the opinion, both on the use of funds on the regulatory and probity side. There is a parallel in education, for example, where it is driven by a self-certification of the systems of control, back to the system of control, and assignment of the auditors, leveraging off the certification. So I would welcome a narrowing.

**Q381 Simon Danczuk:** Just very briefly, do you think that the local authority should be able to determine the scope of the audit? Would that be a good thing?

*I el o nson:* I do not think that would be appropriate. I think somebody else should be setting the scope of the audit and that would be potentially around the annual accounts, although I think that is well-trodden territory and one draws on the normal accounting and reporting standards. For value for money, assuming that remains within the auditor’s remit, I think somebody else should set the scope of work for that piece of the audit.

Can I just say one other thing? In the value for money context I think auditors always prefer to report on something that is attested by the client, be it the directors or whatever. At the moment obviously the annual accounts are indeed certified by the finance officer and sometimes the leader of the council. There is no current attestation confirming, “We have spent money properly” or given a value for money attestation. So the auditor’s conclusion is the only thing that currently does that, and I wonder whether there ought to be an explicit attestation within this annual reporting framework, which requires the authority to confirm they have indeed spent money economically, efficiently and effectively.

**Q382 Simon Danczuk:** Do you think the local authority should set the scope?

*Ma r e or:* I don’t think they should set the scope at all. Carrying on from what Nigel said about the VFM point—and he raises an interesting point there—if you did put that requirement for a test on the officers in a local authority, I think you would end up with a position where they were going out and getting specialists to carry out specific VFM studies on particular parts of their services and, you know what, if they did that that would all be part of what I said before, which is making sure there are adequate controls within the local authority to look specifically at VFM.

*akes a nak:* I think on the attestation I stated my position, which is the same as these two gentlemen. No, certainly, the local authority should not be setting the scope, I do not mean to denigrate that, but I think fundamentally it is public money and so the scope should be set outside that regime.

**Q383 Mark Pawsey:** Chairman, I would like to go into the issue of public interest performance and, Mr MacGregor, you said earlier that the audit of expenditure is traditional territory for accountants and it is accepted that public audit needs to go further than that. Currently, if an auditor finds malpractice or improper expenditure by an authority they go into a public interest report. That is currently funded by the Audit Commission who provide advice and guidance in doing that. Is it your belief that those reports: firstly, should they continue; secondly, does the private sector have the expertise to be able to carry them on if they do, and who should pay for them?

*Ma r e or:* I see the PIR as like an insurance policy or a failsafe. The local authorities know that it is there and it is one of those things that, at the end of the day, keeps them honest—if I can put it like that—knowing that that thing is out there. So, one looks at abandoning that with some trepidation, I think. I would be uncomfortable if an auditor found something, or was told about something, and was not able to investigate it because it was outside scope. To investigate it, it is the age-old problem of somebody paying you to investigate their malpractice, or alleged malpractice. I think that I would feel quite uncomfortable with a situation where I would be going to somebody and saying, “I have been told about this, I want to investigate it. I need you to pay me to do that”. So, I think if you continue PIR, and I think there are very good reasons to continue it, you need to maintain some sort of system of indemnification for whoever it is who is undertaking the investigation.

**Q384 Mark Pawsey:** So you would accept there is a conflict of interest, if the auditor has been appointed by the local authority and the auditor wishes to go further than the original specification?

*Ma r e or:* I think that is consistent with the answers each of us has given in respect of the last question, which is: to what extent should a local authority set the scope? Here you are potentially talking about the local authority being asked to set the scope of a PIR and the best way to frustrate scope is to withhold funds to investigate.

**Q385 Mark Pawsey:** Who should pay for it?

*Ma r e or:* Clearly public funds should pay for it, but how that is channelled to the auditor I think is a different question. It would need to be one of the public bodies.

*I el o nson:* I think public reporting by the auditor should continue and again, in our submission, I think we did make the comment that we think that our audit plans and our end of year reports should be publicly available. I think our suggestion is that matters of particular concern, which are perhaps currently looked at through the special public interest reporting regime because they are tricky issues, unlawful expenditure, or just very serious matters that auditors believe should be investigated and brought out in public, I think those then could be done through that public...
reporting regime and perhaps flagged quite specifically. I think that maybe that becomes a natural part of public reporting by auditors, rather than something that is currently very special and different and requiring quite a different response. So I think there is a refinement and perhaps an enlargement of public reporting by auditors, which could encompass bringing these sorts of special matters to attention. In terms of expertise, most of the public interest reports that I have both read and been involved with I think the auditor has had the expertise to examine. There are some exceptions, and I would make a distinction between public interest reporting and objections. I think objections are much more difficult for the auditor currently, simply because that gets you into quasi judicial and legal areas with potential for challenge, and so on, through the courts. That sort of aspect of the current audit regime is potentially better served, and better value for money would be achieved, through excluding the auditors from that and letting lawyers handle that, or the matter be pursued through the local authority directly. So I think the auditor has the expertise to deal with most matters raised. If they need to take advice they will have to obtain that. Then who should pay and how that mechanism should pay? At the moment, on public interest reports, the audited body pays. The Audit Commission doesn’t pay. So there is a way already whereby it is acknowledged that, if an auditor has to undertake a public interest report, the audited body will pay and they do indeed pay. Now, if you take the Audit Commission away and say, “Well, there isn’t that safeguard to build in with the audit committee to approval by the council?” I think that would be a good recommendation; it is whether they should have the oversight of the profession at the moment, I would be surprised if any professional person would feel put upon not to pursue something if they felt that was genuinely professionally the right thing to do.

Q387 Mark Pawsey: Do you think that the public interest reporting should be funded by an independent, separate body or are you comfortable that it should be paid for by the body that is being audited?

I come back to if there is a very robust audit committee, who is independent and objective around the political colour of the organisation—

Q388 Mark Pawsey: Do you think that the public interest reporting should be funded by an independent, separate body or are you comfortable that it should be paid for by the body that is being audited?

I agree absolutely and completely. I think independence is something that exists all the time and we overcome it quite successfully. Not simply because the regulators are looking over our shoulders, but through being professional and just the way we operate the Code of Conduct.

Q389 Chair: Can I ask: do you really believe that Westminster Council would have paid for the public interest report into its various activities and Lady Shirley Porter?

I come back to if there is a very robust audit committee, who is independent and objective around the political colour of the organisation—

Q390 Chair: We will come on to the objections in just a second, but an objection can lead on to a public interest report, can’t it? If a problem is drawn to the auditor’s attention, which he then deems is worthy of that degree of investigation then that can be the outcome?

I think dealing with the objection and the response to it is typically taken in public anyway.

Q391 Chair: Okay, but in the end if the only degree of independence is that you have an independent audit committee, which I understand you are basically all suggesting might be one of the ways of achieving some degree of independence, should that audit committee have the right to specify expenditure on audit where required, separate from any further approval by the council?

I think there is something to be said for that, to the extent that they believe there is something appropriate
and they feel that it should be investigated and perhaps councillors might not take the same view.

ervase Ma re or: I will also declare an interest. We acted in the defence of some of the councillors against Mr Pickles. If something is sufficiently serious—and let us think about this in the context of the private sector—auditors are going to say something and auditors will threaten to resign or will resign. The same thing applies to members of audit committees if something is sufficiently serious. The world of PLCs has become very challenging over the last couple of decades, as people have realised, non-executives in particular, members of audit committees have realised, that they have real responsibilities and real legal liabilities, in respect of not discharging their job properly. If something is sufficiently serious, such as you have just referred to, I find it very difficult to believe that an appropriately qualified audit committee or group of non-executives wouldn’t make sure that something was investigated properly.

Q392 Heidi Alexander: I just wonder if you think that the right of electors to challenge the financial statements of councils should be retained. If you don’t believe they should, what other process do you think should be put in place to maintain elector accountability?

akes a nak: I think my analogy of the electorate being the stakeholders, the shareholders is particularly pertinent here, so I think that right should still be retained. As to whether there should be a direct access from the stakeholder to the auditor is something I am uncertain about. In fact, I feel it is too stark. I think there should be an intermediary; perhaps an officer, a nominated officer, a sponsor, and ultimately, the audit committee. We have mentioned the audit committee a number of times today having had experienced, both in the public sector and in the private sector. Provided the competition and the skill set within the audit committee is right, they can act as a very good buffer, so I think the right should be retained but not direct access.

ervase Ma re or: I think that is right, the right should be maintained, but going through the audit committee seems to be an appropriate mechanism. Again, this is presupposing that you have properly qualified and experienced members of audit committees. We are hanging a lot on that being one of the big safeguards of the effect of all of these changes.

i el o nson: I would make the distinction between the right to access information about the accounts and the right to challenge the accounts. I think it is entirely appropriate for access to be granted by any elector who wants to understand what money is being spent on, why it is being spent, and I think that is a natural sort of conversation and communication between the elector and the council. In terms of challenge to the accounts, I think that challenge can indeed be made and that right can still be retained to the auditor, but again that can fit very comfortably within an audited body, audit committee conversation. Again, I think it is an appropriate right for the elector to have.

Q393 Heidi Alexander: Was that what you said in your written submission, because I thought there it said that you considered that the extended audit powers to hear and pursue electorate objections should be dispensed with?

i el o nson: Yes. That is objections about legality rather than matters in the accounts themselves.

Q394 Bob Blackman: At the moment, the Audit Commission both commission the private sector to do audits and control the quality consistency of audits right across the piece. With them going, how are we going to ensure that consistency and quality is maintained?

ervase Ma re or: Currently within the private sector and other aspects of not-for-profit, our work is fairly heavily regulated, in our case by the AIU, the Audit Inspection Unit of the Financial Reporting Council, and the quad of the Institute of Chartered Accountants. So there is already sufficient regulation. When you go into other areas where we undertake audits, there are additional regulations through, for example, the involvement of the Charity Commission and all sorts of bodies in higher education.

So I think that, as far as auditors are concerned, there are sufficient controls that could absorb the current role on audit quality. We get inspected once a year; a report comes out. It is the same for Deloitte and the other large firms, so I don’t have any worries as far as that is concerned.

i el o nson: To my mind, consistency would be more of an interest than quality and I think the Audit Commission indeed has played a significant part in ensuring consistency through the guidance it has issued, and so on. There are other regimes where there are mechanisms through which information is disseminated to auditors to help with the consistency in those different regimes.

The NHS Foundation Trust regime is one of those, for example, where there is guidance issued and a forum around which issues are debated and discussed among auditors to ensure greater consistency. There are ways, but I think there would need to be some mechanisms through which those involved did get some guidance about some of the areas where there could be inconsistency.

I would concur with Gervase around the quality aspect. I think firms who are registered under the various regulatory bodies and professional bodies will be ensuring that the work that they do meets the required professional standards, so I think consistency needs to be thought about more in any new regulatory framework than in quality.

Q395 Bob Blackman: So do you think there should then be some form of regulatory body that is introduced to make sure this consistency takes place?

i el o nson: We have talked about the scope of the audit. I think someone somewhere—unless the legislation is going to be very detailed—needs to define, underneath the legislative principle, the scope of audit work. Beneath that, potentially, there could be some formal guidance, be it a code of audit practice or whatever, sponsored by an organisation, which does put more flesh on the bones of what the scope of the audit work here is, and indeed any further guidance that is required by auditors to provide the consistency
and approach for the diversity of the providers. I think there should be somebody given that role and responsibility to set that more detailed code and guidance.

Q396 Bob Blackman: So who do you think that should be?

Gervase MacGregor: It is reported to be the National Audit Office. I think they would be as good as anybody, given their knowledge of audit work. If there were to be a residuary body coming out of the Audit Commission, then there might be somebody else, but I would say—

Q397 Bob Blackman: The Audit Commission in another guise, do you think?

Gervase MacGregor: An Audit Commission, a light regulatory body that doesn’t have its own in-house audit practice.

Q398 Bob Blackman: One of the concerns is going to be that, if local authorities are deciding who the auditor is going to be, they are going to put this out to a contract and there will be competition; they will de-scope the elements of audit and try and get the cheapest possible cost they can. Now, someone somewhere is going to have to oversee that, so who oversees it?

Gervase MacGregor: The NAO, for example, and the Audit Code of Practice is pretty fundamental in this. That is not to say that the Code of Practice would necessarily be automatically followed, but it could be seen to be followed by reviews and so on. So, the NAO, I would suggest, has a role to play in this in the scoping of it, through the Audit Code of Practice in defining what the expectations of the auditor are and that would drive the process.

Rakesh Shaunak: You are absolutely right to have the concern. That is why the scope needs to be properly worked out, so that is what an appointed auditor is looking to when he plans and he undertakes his work; and secondly, to avoid this concern of basically people driving down costs by self-limiting the scope of their work. That is where something equivalent to the annual inspection that we have on our private company audits takes place. That is how you stop local authorities constricting the scope by withholding the fees.

Q399 James Morris: Just pursuing this thing about the Audit Commission; when the Secretary of State decided to abolish the Audit Commission and stated his intention, he did say that the audit practice had done quality work and there was a lot of competency he wanted to retain in there. What do you think is the best model? A few models have been proposed, in terms of mutualisation or a private firm taking on the role and the function that the Audit Commission has. What do you think is the best model moving forward? Now that the Government has decided to abolish it, what is the best mechanism of mutualisation or another process in your view?

Gervase MacGregor: I am not sure I have the answer. There clearly needs to be a proper thorough evaluation of what the options are. As somebody who has worked in this particular sector for quite a long time, I have no question that the level of expertise within the Audit Commission’s in-house practice is something that we need to protect and ensure has some sustained value in any new regime. If they can create a sustainable business case for mutualisation, I think that would be good and I think that would preserve a lot of that capability in one place rather than see it fragment, which I think is potentially the risk with any other alternative.

So the question: can they build a sustainable business case from what they have? Currently it has 70% or so of a market, which is a large share of any market. So the question: can they build a sustainable business case from what they have? Currently it has 70% or so of a market, which is a large share of any market. Again, obviously with local choice becoming available, you wonder again whether that is a sustainable level of market share from day one for any mutualisation let alone going forward. So I think it is a challenge to build a sustainable model, but I would like to think that some case could be made for maintaining the majority of that business in the whole to keep that expertise in the market.
Q400 James Morris: Do you think this move will stimulate more market competition for audit or will we have greater concentration?  
_ interleason:_ I think making local appointment will create greater choice and greater competition. There are many firms who will look at this market and think it is attractive. If it is freed up, and it has been, as I say, a very severely managed market until now with that large in-house share, I think it will create serious competition.

James Morris: Any other views?  
_Gervase MacGregor:_ I think looking at the mutual model, yes, there are attractions and there are certainly attractions as far as keeping the talent, which is currently in the Audit Commission, in one place. The problem is that over time that market dominance is going to be eroded, through a variety of normal competitive means. I think inevitably, where this will end up is that that work is going to end up being shared among a larger group of audit providers. I think that is inevitable over time.

Q401 James Morris: Do you think that is a positive thing?  
_Gervase MacGregor:_ Is it positive? Yes, it is, I believe it is positive, but I also think it is inevitable. I don’t think you can fight the market in that respect. I don’t think you can say, “Here is an almost monopoly provider of 70% of audit services” and then go and let it compete out there in the market. Its share is going to get eroded with time. What is arguably more important is this: there is a lot of talent within the Audit Commission. This was announced some time ago. You do want to keep that talent within audit and I think the longer it goes on before there is some sort of solution to the abolition, the more uncertainty there is obviously in terms of what the new model is going to be, so any benefits that come out of it are going to be delayed. There will also be a lot of attrition at the Audit Commission. We won’t be the only firm that has had people from there approaching us to look for positions because they are worried about what the final model is going to be. So whatever it looks like, I think it has to proceed apace.

Chair: Thank you very much indeed for coming this morning and giving your evidence; thank you very much.

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**Examination of Witnesses**

_Witnesses:_ **Vernon Soare,** Executive Director, Institute of Chartered Accountants in England and Wales, **Gillian Fawcett,** Head of Public Sector, Association of Chartered Certified Accountants, and **Steve Freer,** Chief Executive, Chartered Institute of Public Finance, gave evidence.

Q402 Chair: Good morning. Thank you for coming to give evidence to us this morning. For the sake of our records, could you say who you are and the organisation that you represent?  
_Vernon Soare:_ Yes, Chairman. My name is Vernon Soare; I am an Executive Director with the Institute of Chartered Accountants in England and Wales.  
_Gillian Fawcett:_ I am Gillian Fawcett; Head of Public Sector for ACCA.  
_Steve Freer:_ Steve Freer, Chief Executive of CIPFA.  
Chair: Gillian, good to see you change your hat quite quickly.  
_Gillian Fawcett:_ Changed the scarf.

Q403 Chair: Just to say, we have quite a lot of information and questions to get through this morning, so if you do happen to agree with a comment already made, if you indicate your agreement, we are quite happy and content with that. That helps us get through the business a little more speedily. To begin with, in terms of public and private sector audits, is there a fundamental difference? We will come on eventually to the scope of the audit and public interest, which I will leave for further questions, but just to begin with, the principles of public audit do begin with the independence of public auditors from the organisation being auditors of a fairly fundamental commencement point. Do you agree that should continue to be the case or do you think now it is a time for change and, if so, how should that change be brought in?  
_Vernon Soare:_ Chairman, if I could just start. I think the audit independence is the keystone of any audit activity in any sector. I think one of the concerns that has been raised with the potential abolition of the Commission is: how will auditors demonstrate their independence? I think previous speakers have outlined the position, which I think I would agree with, that the future audit committees in local authorities should be given a statutory basis and given new powers, to ensure independence, at the appointment stage.

Of course, independence is borne out in much more than just the appointment. It is borne out in how the work is carried out, the decisions auditors take and also with issues such as fee dependence. One of the safeguards of independence is an audit firm does not have a significant amount of its audit fees tied up in one client. So I think independence is absolutely crucial but it is more than just the appointment. It is the appointment process but it is how they conduct themselves. Auditors also work against a code of ethics and that code of ethics is very similar across the public and private sectors.  
_Gillian Fawcett:_ To perhaps elaborate on that, I think, yes, independence is absolutely critical and it is fundamental to audit. In terms of an institute, I am quite torn about how you secure independence because, on the one hand, we have had 150 years or
such of the independent appointment of auditors. It has been a system that has worked and there has been 150 years of learning in terms of that system, so why throw the baby out with the bathwater?

On the other hand, yes, we certainly are supportive of audit committees and strong audit committees, which have the potential to fulfil that role in ensuring auditor independence, but there is a big question mark, I think as an institute, in terms of: where are you going to get those people from—with those relevant skills and experience—to sit on those audit committees? There is going to have to be a substantial investment in resource and training for those people on audit committees. As you can see, I am quite torn there. Yes, supportive of audit committees in terms of certainly building up the resource and skills. In terms of the context in which public audit takes place, I think it is very different because, of course, taxpayers don’t have a choice, in terms of whether to disinvest, paying their taxes if they have failing services or poor governance. They have to pay it anyway. You could argue, well, yes, then they can vote you out in every four-year term, but four years is a long time to suffer poor service delivery and poor governance. So, yes, I think there is a very different context in terms of public sector audit and independence is absolutely critical.

**Leve Reer:** First of all, I think that public sector audit is different, and we will probably talk more about that when we talk about scope a bit later on. Secondly, to make the point that I think the principles of public audit are very important, all of them, but perhaps it is fair to say that the independence point is the most fundamentally important. I think there are dangers, if we get that wrong, that the relationship between the auditor and the public body may become too cosy and not serve the public interest. I think there is a danger that authorities might try to exert undue influence on auditors, and use the fact that they make the appointment as leverage in that exercise. Also I think there is a danger that auditors will be influenced by considerations about their own risk in some of their decision-making in their role as an auditor. If you decide to pursue a line of inquiry that may lead to a major public interest report, for example, in that process you are almost certainly exposing the firm to significant potential liabilities, and there is a danger that those will weigh heavily on the auditor in that decision-making. So I think, for all of those reasons, the independence issue looms large. The key issue is about how can it be assured? I think it has been assured in quite an elegant way while we have had the Commission. Question: how can it be assured if we don’t have the Commission? I think beefing up audit committees obviously are an option, but I think we really have to drill down and pursue exactly how that would work. The question about: what does independence mean? Independence from whom? Who makes appointments of independent persons and assures that they are truly independent? I think all of those are very difficult issues. If we get them wrong, there is a danger that we weaken independence.

**Q404 Chair:** Any ideas how we might get them right?

**Leve Reer:** Personally, I think that the residuary Audit Commission option—if that option exists—is quite attractive. I think the notion of a separate, independent body overseeing those kinds of processes, possibly being involved in the selection and possibly making those appointments, potentially has a lot to commend it.

**Vernon Soare:** Chairman, can I just say on that how we can improve that or how can we guarantee independence? First of all, we must remember that audit firms will have a reputation to be concerned about. I think it is highly unlikely that a firm—particularly if, as I mentioned, there is not an issue on fee independence—is going to cut its cloth in the face of opposition from a local authority. Secondly, as has already been mentioned, the inspection and review regime that is carried out in the private sector, and is currently carried out in the public sector by various bodies, takes those things into consideration as well. Therefore, I think that independence, if you line up with the code of ethics, the reputational issues, safeguard against fee dependency, and you have a strong audit committee, I think you probably have a safety net there that will work.

**Gillian Fawcett:** I would like to concur with Steve. As I said, in terms of there being years of learning in terms of the current process in relation to auditor independence, we haven’t suffered the same vagaries in terms of what is happening within the public sector on independence, particularly around areas such as the degree to which you carry out non-audit to audit work, the spotlight that audit has been put in, in relation to the banking crisis. So I strongly support that, in terms of we need to think are we going to put those 100 years at risk?

**Q405 Bob Blackman:** Can we come on to the scope of audit work? Why is there a difference between the private sector and the public sector and what is it? Mr Freer, would you like to start?

**Leve Reer:** I think the current scope is normally summarised over the four headings that I have no doubt you are familiar with: the opinion on the financial statements; regularity; probity, and value for money. It seems to me that all of those issues are fundamentally important when we are speaking about public money. Perhaps value for money stands out among those as being a paramount consideration for a taxpayer looking to his or her local authority. Perhaps the most obvious question to ask is: how has my money been spent and has it been spent wisely? It seems to me that that package of elements that make up the scope has a nice balance to it and does feel very appropriate. Why the private sector is different, I wouldn’t venture a view.

**Q406 Bob Blackman:** If I was a shareholder in a company, I would want to know that the directors of the company were spending the money valuably but, okay, we move on. Can I just say if you agree, and I guess you will, who should determine the scope?

**Gillian Fawcett:** I think it has been proposed in terms of there will be somebody, such as the National Audit
Office, that would determine the scope under the Code of Audit Practice. Currently the Audit Commission control the Code of Audit Practice at the moment and that will pass to the NAO. I think it needs to be set at a national level, to address those issues certainly around consistency.

Back to the four areas, I think you have to be clear that audit, whether in the private sector or whether in the public sector, needs to be risk based and proportionate. You shouldn’t be doing unnecessary audit work and you should be taking into account the controlled environment of that audit. At ACCA, we fundamentally believe for the opinion and regularity work, there is no real difference at all between private sector and public sector audit; there is no difference. We follow the same auditing standards in those areas. The differences lie in terms of the probity, in terms of the legislation and does expenditure comply with legislation and guidance, and the value for money.

Going back to what I said earlier, in relation to the value for money, taxpayers do not have a choice in terms of where they invest their funds unlike that of an investor in a company. So when things go wrong, they can’t withdraw their funds and, at the end of the day, they are interested in efficient and effective services being delivered and the value for money element provides some assurance that that is happening, or at least the local authority has the right arrangements in place to ensure that effective services are delivered.

Q407 Bob Blackman: Mr Soare, what would your view be on the value for money studies? How valuable are they?

ernon oare: I think in the past, the value for money studies carried out centrally by the Audit Commission, and then carried out at local level, have proved quite useful. If not least, that there is a common benchmark for performance that a national study can discover, looking at good practice and best practice and then disseminating not just the benchmark but how it is done.

Chairman, if I can also say on the difference between the public and private sector, and why is the scope wider? I think it interesting that pre the Audit Commission, all local authorities came out into the Department of the Environment. I am not sure that in those days it was part of the remit. I think the value for money study, as we know it, was essentially a creation of the Audit Commission in 1982.

The difference between the public and private sector, I think it is quite simple. Why is the scope wider? In the public sector, judging the performance of any public body purely on its financial results, I think is quite difficult; that is one, but there are measures of performance indicators: policy implementation, quality of services, and so on. In the private sector, and if you are a shareholder, most often you are interested in the bottom line and if your company that you are investing in is turning a good profit, you will probably be satisfied; if they’re not, you won’t. I think that is probably the genesis of some of the differences.

Q408 Bob Blackman: Could I move on to another area? Obviously there is a substantial amount of grants and claims that local authorities make on Government. For example, I can think of one, the Housing Benefit subsidy claims that need to be audited. Who is going to do that in the future and how is it going to be paid for? Vernon, would you like to start?

ernon oare: If I may start, yes. Under the current regime, the audit of those grants is carried out by the appointed auditor. I don’t see that there necessarily needs to be a change in that arrangement, in terms of the auditor on the ground who looks at that expenditure. I think the issue is going to be—post Audit Commission—how the instructions or the agreed procedures auditors carry out are going to be determined. Currently that is done through the Audit Commission. In the future, I think the onus will fall back particularly on the Department concerned to publish agreed procedures.

Q409 Bob Blackman: So do you think there needs to be some regulation there on that whole process?

ernon oare: I think there needs to be some consistency as some of the previous witnesses have said; some consistency in approach by auditors, so that taxpayers and, in this case, Government, can be assured that there is a consistency of approach to auditing the disbursement of funds under those grants.

teve freer: Could I just add; I think there is a question about whether every individual grant claim requires a full, separate certification with an associated fee. A possibility might be that one could design a regime where some of that could be handled within the primary audit and whether, in that process, the audit—

Q410 Bob Blackman: Sorry, could I cut across you? Do you think that should be limited by an amount of money or a particular function? How do you think that would work?

teve freer: I think possibly by the level of the claim, by the amount of money because I think there must be grant claims that are de minimis, which don’t require the gold plated treatment that they currently receive. I think that would streamline the process and also potentially save public money that is associated with the way that work is reimbursed at the moment.

Bob Blackman: Thank you. Gillian, do you have anything to add?

illian a ett: I totally agree, in terms of it should be the appointed auditor. I think the Commission is fairly successful in reducing the number of audits on grant claims over a number of years, but again, in terms of the onus, as Steve said, in terms of Whitehall, to consider whether it is necessary and to be more trusting if they are giving grants, particularly small grants, across to local authorities, to reduce the requirements of a full audit.

Q411 Bob Blackman: Do you have a definition of “small” in Government terms?

illian a ett: I haven’t thought about it, in terms of the definition for grant claims that are obviously moving to something such as the small audit thresholds that are being considered in terms of small parish councils and audit.
Bob Blackman: That is very helpful, thank you.

Q412 Heidi Alexander: I would like to follow on a little bit with the discussion about the scope of audit and, in particular, the value for money work that is done in local authorities by audit teams. I think it is an area that we haven’t put to any of our witnesses as yet, which is about: the Government has significant plans for decentralising services and in their localism agenda. You could see the situation where local authority services are more fragmented, geographically speaking, with an impact perhaps on the services retained within the authority, the residual services, in terms of what value for money that offers the taxpayer.

I just wonder what challenges you see with new models of service delivery perhaps becoming more commonplace across the country, what the challenges are you perceive to be for audit in this new world, and whether you think that there is any need for any guidelines to be published around how the audit function deals with those sorts of issues?

illian a ett: To be quite frank, I don’t think it has been considered at all in terms of the new audit framework, and this obviously goes beyond the remit of the Committee. So in terms of if you were to start with a blank piece of paper, thinking about the new models in terms of mutuals, partnerships, and so on, there needs to be much more thinking in terms of how audit will work and Government’s accountability for how these new bodies will work in the new regime. It is quite difficult to say but there will be issues around consistency, accountability, governance, accountable to whom, co-ordination in terms of auditors. So it raises a whole of host of issues that need to be properly considered.

teve reer: I think you are right to say that moving to the future you have described, inevitably there are some risks in that process and potentially that, therefore, giving an opinion on value for money looms larger as a very important function of auditors. Additionally, of course, perhaps even more importantly, we are going into this period of austerity with a whole series of further risks associated with how the financial position of public bodies may cope or not with big challenges. Again, that seems to me to raise important issues.

Then I find myself thinking that, ideally, we want assurance about those issues and how all that is playing out, not only at individual authority level but also on a system-wide basis. I think that is one of the areas in which the Audit Commission value for money work has been very helpful in the past, it has managed to give that big picture overview, in relation to particular issues, and has sometimes focused on some pretty important emerging issues in the sector. Also, it has managed to give a local perspective too, and sometimes the overall picture has been a fairly satisfactory picture but the local picture has been a matter of significant concern.

Q413 Heidi Alexander: Okay; different question now about the national value for money studies that were carried out by the Audit Commission. Do you think they were valuable and useful pieces of work to do and if they continue in the future, who should specify them and who should carry them out?

illian a ett: I think, in the terms of the Commission’s national value for money studies, they have had a significant impact in terms of across the sector, in that they have had the ability to address the wicked issues. Those are perhaps issues at a local level that a local authority at a local level would not want to address. They have helped to transform some public services and to spread practice, not necessarily best practice because I know we get into other ground there. They should continue and I think what has been proposed is the National Audit Office, which would be the logical place to go, given that they have a very excellent track record in carrying out such studies.

tevon oare: I have nothing to add to that, I agree.

teve reer: I agree too. I would say though that I do think it is important that there is a consultation process associated with the specification of those projects, which the Commission has always consulted authorities on, on its draft programme, and so on. I think that is a helpful arrangement.

Q414 Chair: The LGA are saying they would rather like to have a stake in this as well. Do you think that is a bit too close to home? That they will be able to effectively look at value for money across their own member authorities? Some of them are probably not their member authorities, as we understand, or do you think they could play a role with the National Audit Office?

teve reer: First of all, I think that in that consultation process that I just referred to, it would be really helpful for the LGA to be an active participant giving its views about what studies should be undertaken and how they should be designed. Secondly, in a way, that question almost bridges us over into the inspection functions that the Commission has carried out, and I think that the LGA taking some responsibility for what they are calling self-regulation and improvement in the sector, I think that is a very positive step. I don’t think it is an easy step and, clearly, we don’t know yet how successful the LGA will be in taking on that responsibility or accepting that responsibility. I do think that is a very positive move by the LGA.

tevon oare: Just one thing to add. I think whatever happens in future on studies, I do think we need to be careful to bear in mind proportionality. I think there has been some criticism in the past that some of the Commission studies were too heavy, too onerous at the local level to carry out. I think we need to take a step back sometimes and remember that local authorities are a subset. In one sense, they are not insignificant but not as large as some areas of public spend. Therefore, when you look across the range of work that is done by auditors across central Government, the health sector and local authorities, we are saying maybe we need to keep a little bit of perspective on occasions, so that we don’t get into potential overemphasising, depending on the size of the authority and the significance of the activity that is being carried out.
Q415 Mark Pawsey: We heard earlier from the private sector audit companies that are going to be carrying out public sector audit that they will be happy and keen, in fact, to carry on public interest reports. They are quite happy for that to be paid for by the bodies they are auditing and they don’t see any conflict of interest or any way in which their independence might be compromised. They might say that, mightn’t they, because they are the ones who are going to be fishing for the business and they see that as quite an interesting additional revenue source. What is your view?

teve reer: I think public interest reports are very important and do need to be continued. We need to make sure that in these new arrangements, we don’t create any obstacles to public interest reports being produced where they need to be produced. I think there is a logic in them being paid for by the authority concerned. That makes sense to me. I think what we need to avoid, however, is a situation where the auditor has to negotiate that fee with the authority. Again, I think we are then left with a very difficult circle to square. That takes me back to the residuary Audit Commission option. Again, for me, that would be a very sensible function for an independent agency to be able to mediate if necessary.

Q416 Mark Pawsey: So you think there is a danger that their independence might be compromised, that there needs to be somebody separately funding and managing that.

teve reer: I am not so sure it is about independence being compromised. It feels to me more like a very difficult conversation to take place between an auditor wanting to pursue a matter—

Q417 Mark Pawsey: So do you fear then that on occasions that conversation might not take place?

teve reer: Yes.

illian a ett: Yes, public interest reports should continue obviously, in terms of they bring to light serious failings within authorities. So who should bear the cost? I think we perhaps need to look across at the Companies Act and what provisions are within the Companies Act for big scandals, such as the Maxwell scandal, in terms of where those sorts of serious failings resulted in investigative inquiry and an inquiry by the Government, in terms of maybe drawing the lessons there and whether it should be in terms of the Government picking up those costs.

Q418 Mark Pawsey: Do you share Mr Freer’s concern that, on occasion, an auditor might find something and not want to have this difficult conversation with the client local authority?

illian a ett: Absolutely.

Mark Pawsey: You do share that position?

illian a ett: I do share that.

eron oare: Maybe not a contrary view but a step back. When we are thinking about the future of local public audit and local authority sector, I think that the period does represent a very key time to look at the landscape and to decide whether some of the things pertaining to the local authority audit should continue in exactly the same way. The point I just made is you look across the public sector, audit regimes are quite different and local authorities are virtually unique in some of the aspects of the audit procedures and some of the powers and some of the responsibilities. When we are talking about public interest reports, I think maybe it is just an opportunity to stand back and say, “What is their purpose? Could they potentially be delivered in a different way because they are very expensive?” That is not the reason for saying you shouldn’t do them. If you look across other parts of the public sector, in the health sector there is not an equivalent, in the sense that the report goes to the Secretary of State; it is not a public report and I don’t think there is an equivalent in the central Government area. There may be a very good reason for continuing in the local Government sector but I think, probably before we carry on business as usual, it might be worth stepping back and saying, “What is the purpose? Could it be achieved in a different way?” Maybe not, but I think it is an opportunity to look up a little bit.

Q419 Mark Pawsey: broadly, you think it is acceptable for the company carrying out the audit to do the public interest report or would you rather see another independent body stepping in, in those circumstances?

eron oare: Again, I think it comes back to the issue of independence. My own view is that, looking at what has happened over the period of the Audit Commission, I think public interest reports have been issued without fear or favour. Personally, I don’t believe that there has been a lot of connivance, or anything of that sort, but if it was deemed to be appropriate in the public interest, you could imagine a separate appointment of either another audit firm or some other specialist to look into that particular issue. Hopefully, what we are talking about is incidents that do not happen every week. What we are talking about is catastrophic issues. Yes, they have come along perhaps more than they should have done, but this is not something that is essentially part and parcel of local Government life.

Q420 Mark Pawsey: On that basis, is there a danger that an auditor might find more opportunities to have a public interest report in the interests of enhancing their fee?

eron oare: I think, from the point of view of ethical standards, auditors would be ill advised to do that. My experience is that, if we are getting down to fees, the sort of fees that auditors generally receive from local authority audits are generally less than those in the private sector. There will be an opportunity cost issue there I suspect. I certainly don’t think that auditors will be going out trying to make work for themselves in the public sector.

teve reer: Could I just make the point that I am more worried about the opposite set of circumstances, where the auditor can see the possibility of a public interest investigation and can see the potential liability that that exposes the auditor to. So you end up with an unenthusiastic auditor contemplating having a discussion with a potentially unenthusiastic client authority. It is in those circumstances that I think these
conversations might never take place. The Commission has helped to keep everyone honest in those situations in the past.

Q421 Chair: So you would see a situation where the auditor wasn’t appointed in future by the Commission; there could still be a role for the National Audit Office, or whoever, in supervising and overseeing these processes?

teve reer: Possibly.

Q422 Simon Danczuk: How should the quality of local Government audit in audit firms be assured? You have talked about consistency of service. Whose responsibility is that, and the Audit Commission played some role in that. Whose job is it then?

ernon oare: Yes. The Audit Commission has arrangements currently for assuring the quality and consistency of audit across audit firms and indeed their audit practice arm. Up until recently, that was done through an arrangement where the Audit Commission would have its own quality assurance reviewers. More lately, some of that work has moved to the Audit Inspection Unit of the Financial Reporting Council. In the future, there are various options. It could be carried out by the audit bodies such as ourselves, but we are not exclusive in that domain. Also some of it could be carried out by the Financial Reporting Council. There are various ways in which it could be done, in the sense that I think the potential demise of the Commission will not change the potential, the resource for doing that work.

Q423 Simon Danczuk: Do you have a preference?

ernon oare: If you are asking me who should be doing it, of course we would like to do it. You might say we are biased in that, so we will leave it to policymakers but we are ready for the call.

Simon Danczuk: Any other views?

illian a ett: I think with the Audit Commission it was generally well understood across a number of stakeholders, in terms of how quality assurance and consistency was maintained, and that is with local authorities themselves through to the professions. I think, yes, as Vernon outlined, there are all sorts of alternatives there but, at worst, you could get a fragmented approach in relation to consistency with the professions overseeing bits in an uncoordinated way: the FRC having a role; the Audit Inspection Unit, part of the FRC, having a role there. So you could have a fragmented approach that might not be the best possible outcome for local authorities.

Q424 Simon Danczuk: A fragmented approach does not sound like the best solution, does it?

illian a ett: It doesn’t, no. It needs to go with a single body, possibly in terms of the body that is overseeing the Code of Audit Practice.

ernon oare: Yes. The fragmentation issue: there is a parallel in the private sector, in that there are a number of—what are called—recognised supervisory bodies under the Companies Act who carry out work in audit quality. Their work is overseen by the Professional Oversight Board of the Financial Reporting Council. Therefore, the consistency issue is dealt with in that way.

Simon Danczuk: It sounds very complex to me.

teve reer: I agree with the points that have been made, although this takes us back in a way to a wider scope. It is important that quality understands the wider scope of the public audit. So I suppose this is about saying that it is important, if we start from a private sector model, that we don’t implement that thoughtlessly on the basis that a public audit is the same as private audit. We do need to recognise public audit is different and wider.

Secondly, I thought in the earlier session one of the panellists began to make the point that there is a sort of difference between quality and consistency here. Again I think it is terribly helpful that, under current arrangements, the Commission do help to create a degree of consistency across the sector in terms of how particular types of transactions are regarded and treated, and so on. One thinks of obvious examples like PFI schemes. I am not sure that that consistency, in that very helpful sort of way, will be addressed straightforwardly in quality arrangements.

Q425 Simon Danczuk: So who do you think should do it, Steve?

teve reer: I do think there is a huge benefit in having a body that can convene all of the auditors in the sector, ensure that those kinds of issues are debated and that there is then a process for issuing guidance to all auditors to promulgate consistent interpretations.

Simon Danczuk: Sort of a commission for audit.

teve reer: Yes, an excellent idea.

Q426 David Heyes: The Government have claimed that fees will reduce due to the increased competition. Is there any evidence to support that?

ernon oare: If I could make a comment on that. In a sense, we are going into unchartered territory. For the duration of the Commission’s reign, it has been a regulated market. The Audit Commission have acted as a regulator on audit fees. In future, if the policy is to have local authorities appointing their own auditors, you are potentially in an unregulated market. At that point there will be a number of issues that come into play not least the fact that, under the present regime, the Audit Commission takes a large share of liability issues away from the audit firms and the in-house practice. In future potential markets, those sorts of issues will be dealt with at a firm level with the local authority.

It also depends particularly on the complexity issue. Under the current arrangements, I believe firms are offered in a sense a package of work, some of which might be fairly straightforward; others might be quite challenging. In a future market, the difficult audits or the risky audits will be priced accordingly unless there is some other mechanism for regulating audit fees.

illian a ett: ACCA is supportive of the wider market in terms of opening up competition, and we said that in our submission. We have also said though there is little evidence or no evidence, in terms of knowing how the market will react; and thirdly, in terms of you obviously have to think about what will
happen with the Audit Commission in the future because that will have a direct impact on the market. As Vernon quite rightly said, the Audit Commission basically underwrote a significant limited liability for the firms. That will have an impact in the firms having to potentially take out additional insurance to shore up that liability; so no evidence as such.

Teve Reer: I agree with that, and I think it is likely that some audit appointments will not be particularly competitive, because of the location of the organisation or its reputation or whatever. In those circumstances, there must be a risk of fees increasing. Also, I think, not only the removal of the Commission but also the removal of a public auditor, the sort of district audit arm of the Commission, has in effect had a price regulator function. In a sense, it has also been an auditor of last resort, in that it has been able to be directed to undertake audits anywhere in the country. I think all of those aspects of the current system; their removal creates risk around the market being less than competitive and prices increasing.

Q427 David Heyes: So, from all three of you, no evidence that there is likely to be reduced costs but significant risks that there could be increased costs; the removal of the Audit Commission is a kind of regulator of price. Will there be competition in this market, I think is the question. There are going to be four big dominant firms. Is it not the case that that is likely to result in less competition?

Teve Reer: In all of this, it is important to say that none of us know because this is the future. From experience we do know that it is quite difficult for firms to break into this market because of its specialist nature. We know that firms do need to attract a critical mass of work in order to sustain their involvement in the market. That presents a difficulty too. Additionally, I think it is important to recognise that local authorities are like lots of other entities; almost certainly, they will not be making these decisions purely on the basis of price. Like large listed companies, large local authorities will be attracted to the firms with the greatest cache associated with their names. So I think for all of those reasons—again, while emphasising no one knows—there are dangers that there may be a concentration of the market in the hands of quite a small number of players.

Q428 David Heyes: Is this another argument for a residuary Audit Commission then, to have some oversight of this model?

Teve Reer: I think this is where we find ourselves focusing on the district audit partnership and what happens to that. Again, I think, for me the best option there, sadly, may be the option that is not available. I think a significant public sector auditor in this equation is extremely helpful. If you think about it that is what we have with the National Audit Office and its arrangements in central Government. I think there is a very interesting debate about mutualisation and I am sure that, in some ways, there are some positives in that option. It is important to recognise that a mutual is not publicly owned. It is just a different part of the private sector, and won’t straightforwardly carry out some of the functions that a public auditor can carry out in the market.

Vernon Soare: If I could make one more comment on the market, following on from Steve, about the position of the Audit Commission practice arm and its future. In one sense, it represents a little bit of a conundrum. You could view the fact that if it is able to continue in the market that it will act in one sense as a regulator in the short term, because of its market share. However, the flip side of that is that there will be an immediate market concentration issue into one large firm, which has obviously been the subject of much debate in the private sector. So there will be some issues there to grapple with. One other point to make on the in-house practice arm, as it currently is. Currently, it would not be capable of auditing in the private sector. It would not be capable of auditing, for example, in the university sector, housing associations, because it is outside its remit at the moment. Generally speaking, it does not have the staff with the right kind of background. I know it is on public record that there is a desire for that in-house practice arm in the future, if it is able to stay together, to move into some of those areas. I think it is important that if it is retained it is given as much commercial freedom as possible so it is, in a sense, competing on a level playing field.

Q429 James Morris: You started to touch on this issue about whether the Audit Commission should go down a mutualisation model or other, and, Ms Freer, you were expressing some concerns about that. Are there any other models that you think might be more appropriate to stimulate this market competition that you are talking about?

Teve Reer: I think I have already said that the option of the service staying in public ownership should be seriously considered.

Q430 James Morris: Don’t you recognise the issue, which was brought up in the previous session, about a body being both a regulator and an auditor? Don’t you think that that poses potential conflict of interest issues?

Teve Reer: If what used to be called the District Audit Service stayed in public ownership, it could stay in public ownership and simply be an audit provider. It doesn’t necessarily have to have the regulatory function. Although, I would say that I think I disagree
with the points that were made in the earlier session. I think there is a strong track record of both the Commission and the NAO, and other auditors in other parts of the UK, managing to carry out those different functions successfully under the same umbrella. If public ownership is not possible then I think mutualisation is a very interesting option to consider. I know that the staff concerned are working hard on that, and I think there is a significant head of steam for that option. They are very keen to make it succeed. As I understand it, they are very keen to carry distinctive values from the Commission as it currently exists or from the District Audit Service as it currently exists, into the new mutual organisation.

Q431 James Morris: Sorry to cut across, but, Mr Soare, you were saying you thought it was important that any new body had quite a wide commercial scope.

ernon oare: Yes.

James Morris: so how would you see that working in this mutual model?

ernon oare: I think, in terms of the form and the structure, that any ongoing audit practice arm might take, I think in a sense it does come down to whether you retain it within the public sector, in some shape or form, or whether it goes in to the private sector. If it then goes into the private sector mutualisation is one option. It could be bought out as a private firm and put on a similar basis to others. There are advantages and disadvantages to that. I would agree with Steve, that I think the ethos of the Audit Commission practice arm will probably lend itself more to a mutualisation model than to a straightforward partnership model, but I would say that is something that you would have to give the management the opportunity to determine. Also just to clarify one thing because maybe I wasn’t quite clear, when I mentioned about the Audit Commission’s current capabilities that was no reflection on the staff, I think all the bodies represented here, and others too, have staff working for the Audit Commission. It is just that, under the current regulatory framework, there need to be individuals in the organisation that can be recognised under the Companies Act. There are few of those currently within the Audit Commission, but that could be rectified in the future through training and hiring.

Q432 Mark Pawsey: To go back to the question of audit fees, isn’t it the case here that there is a whole new market becoming available to the private sector. In other areas where big, new markets become available, the private sector competes very aggressively to get a toehold into it. So, isn’t it likely to be the case that we will see those savings in early years? A greater concern might be that, having established the market, the cost may be higher in later years, but in the intermediate years we should see a significant saving as the sector goes for it.

Steve reer: Yes.

illian a ett: Yes, I think that is one possibility, as I say, we really don’t know.

ernon oare: Just to say, of course, 30% of the market is already with the private sector, as in central Government as well. So there is some private sector involvement already. Yes, absent the Audit Commission, it will be for the market to decide and I think that is a policy issue as to whether that is an appropriate way going forward, or whether there does need to be some—not the reinvention of the Audit Commission or Commission for Audit—sort of regulatory function.

Chair: David?

Q433 David Heyes: Yes, I wasn’t on the right page, Chair. It is the question about the threshold for audit. It has been a subject of much debate and we now know that it is going to be set at, I think, £6.5 million. Is that the right level and what are the risks attached to setting it that way?

ernon oare: Can I just say, that that audit threshold is taken directly from the Companies Act and the current upper thresholds set by the European Commission, so that is an entirely private sector concept. I think from our point of view—and I think Steve mentioned this earlier on—we would caution applying things across from the Companies Act without stepping back and thinking. Members of the Committee will know that there is a thought that in future that threshold for the companies might be pushed up even further, even to £25 million. I would probably say that for public money you need to be thinking about a different set of thresholds. I can’t give you a figure, but the point I am trying to make is that just translating over from the Companies Act, which is a £6.5 million limit currently for where statutory audit starts, is probably not the best way to go for the public sector.

illian a ett: I think, in terms of moving the threshold up, you could put at risk a significant amount of public funds. So £6.5 million might not sound a lot for a single district council, but when you start to add them all up perhaps the question needs to be asked: are we going to accept less assurance and accountability for the size of funds? If you look at expenditure, in terms of local authorities and totality, it is around £200 billion. So, adding up the district councils, how much of that spend will be at risk?

Steve reer: I agree with the points that have been made, particularly Vernon’s point about this figure not rising routinely without careful consideration. I think £6.5 million is not an unrealistic figure at the moment.

Q434 David Heyes: There are risks attached. What sort of risks might we face at this level?

Steve reer: Any misuse of public money is potentially a matter of significant public concern and the audit is a process that has the potential to expose issues of public money. It is tempting to want a full audit of all public expenditure at any level in our systems, but I think there is a proportionality question. We do have to take a view about the point at which we suspend full audit and have some alternative arrangement, or else we end up with a very expensive audit regime.

Q435 David Heyes: Your colleagues are saying, quite clearly, the Government have it wrong, translating across from the private sector and setting
it at too high a level. What level would your expertise cause you to suggest?

**Vernon Soare**: Chairman, I can’t give you a figure but I would just say this: the difference between £6.5 million in the private sector is that suppliers and others can choose, either to do business with a company that is below the audit threshold and therefore does not need an audit or one above it. I think the issue for taxpayers is that, generally speaking, they will not have a choice of where their service comes from. Therefore, I think careful thought does need to be given before you go with £6.5 million. If that is the decision in the end all I would say is to decouple it from any idea that this is part of the Companies Act threshold, because as I say every time the Companies Act threshold goes up, which is a completely different policy decision, it would be unfortunate if, de facto, it was linked to the public sector threshold and that went up too. I think there needs to be a separate bit of thinking going on.

**Chair**: We will move on briefly to the last two points.

**Q436 Bob Blackman**: Obviously one of the points of concern is going to be auditor independence and one of the ways that can be achieved is rotating audits. If you agree with that what should the period of rotation be? Steve, do you want to start with that?

**Steve Freer**: I am not particularly enthusiastic about auditor rotation in these circumstances. I think if we put the emphasis on independent appointment then I think that is the right place for it to be. I think—

**Q437 Bob Blackman**: Sorry, just to cut across on that, should there then be an annual appointment process or should it be for a period of time?

**Steve Freer**: No, I think auditors should be appointed for a term but with the potential for that term to be renewed. Within those considerations, I think a public body responsible for making those appointments would naturally consider whether it was healthy for a body to have the same auditor for a very extended period, 15, 20 or whatever years. So I think that would be dealt with naturally as part of that policy responsibility. I think, moving away from that kind of model and making individual organisations responsible for their own appointments but then saying, “you will have to change your auditor every years” seems to me to be a less good model. Because, of course, every time that you get to the point of change there is a whole range of experience and knowledge, about the audit and about your organisation, that is walking out the door and you are back to the bottom of the learning curve. So, for me, it is an unattractive model in a fundamental way.

**Gillian Fawcett**: In terms of to preserve independence, I would say there should be a set term in terms of rotation of the firm not just the partner. Again, in terms of very much what happens in the private sector, it is—occasionally—well, not occasionally, on quite a significant number of times—translated into the public sector. So, for example, the European Commission has published a report and one of the issues that it will be making recommendations on is, indeed, auditor appointments.

**Q438 Bob Blackman**: So if you agree with rotation, what should that rotation period be? How long should an auditor be there for a term?

**Gillian Fawcett**: I would have thought no more than five years.

**Vernon Soare**: Just a comment from ourselves on this, going back to a principle that I think we should not overcomplicate issues in one part of the public sector unless there is a very good reason. I think we should probably step back from making different arrangements and different regulations for one part of the public sector. I would say that the ethical code that currently exists for audit, which insists on the rotation of the main engagement partner at least every seven years, should be something that should be translated across into the public sector. In terms of localism—the local agenda—I believe that this should be a decision for the audit committee. It will be empowered to contract with an auditor for a certain period of time. That will then be reviewed and either, through a tender process, reappointed or move to a new auditor. If the same firm is retained, I think the general principle that applies across the private sector, and some parts of the public sector, is that the audit engagement partners should be rotated after a maximum of seven years. That is in line with standard practice.

**Q439 Bob Blackman**: One other area I just want to touch on: the potential for consultancy studies in local authorities is huge. Should the firm that is appointed to do the auditing be barred from even competing for the potential for consultancy studies? Vernon, would you have a view?

**Vernon Soare**: Right, well, this obviously has been an issue of great debate across the private sector as well but, referencing the Audit Commission, I believe that there was very limited scope for auditors in the public sector appointed through the Commission to carry out consultancy work, and that was for this independence issue. Now in the private sector we have the situation where an audit firm auditing a public interest entity, under ethical standards, is not allowed to do consultancy work for that particular client but can do consultancy work for clients that it does not audit. Therefore, I think if you translate that across into the public sector, because we are dealing with public money, it is probably a good idea that there are some restrictions put upon the amount of consultancy work that a firm auditing a local authority could do for it. Anything major, I think, the same principle should apply, that it is open to firms to do consultancy but not for the authority they are auditing.

**Bob Blackman**: Thank you. Gillian, do you agree?

**Gillian Fawcett**: Yes, I do agree.

**Bob Blackman**: Thank you. Steve?

**Steve Freer**: I agree with that too. I think that it does have the potential to, again, query the independence relationship. So I think it is important to have those kinds of restrictions, perhaps just with a caveat that there might be a situation where there is an absolutely compelling case, because of specialist expertise, that the right decision would be to involve the auditor. Authorities ought to have to jump through some hoops.
before they get to that and I think it ought to be very much the exception rather than the rule.

Q440 Mark Pawsey: Can I ask you about the Audit Commission’s anti-corruption anti-fraud work, what arrangements should there be in a post Audit Commission era?

ernon oare: Again, this is a role that the Audit Commission carried out in terms of co-ordinating the work and even leading on methodology, particular computer interrogation technology and applications. I do not have an easy answer to this one. I think it is an area where, if you are going to get consistency, you do need a body of some sort or somebody taking on the function of leading on this and then disseminating the good practice, the techniques and the technology across other suppliers.

Q441 Mark Pawsey: What happens in the private sector?

ernon oare: In the private sector what you will find is that the firms will develop their own non-assurance service in this area and they will make it an issue of competition, in terms of their expertise. So it is different in the private sector but, as we are dealing with public money, I think there is a good argument for saying that this is not something that necessarily lends itself to a market solution and there should be some co-ordination of it.

illian a ett: Yes, I think in terms it certainly is a valuable function. It has identified areas of fraud across a whole host of areas, certainly through its data matching exercise, and I think it does need to continue; with what body? I think there have been various bodies mooted such as the National Fraud Authority, which might well be an obvious place for that. Again in terms of the way different functions are potentially being fragmented across different bodies in an uncoordinated and inconsistent way, which is possibly of concern, but certainly it is a function that should continue because it does identify areas for potential fraud and significant fraud across local authorities.

teve reer: I agree with the points that have been made, and just to say I think it is also important to recognise this expertise, centre of excellence, and so on, has been built up at considerable public expense. So there is a public investment here that needs to be protected.

Chair: Thank you, all of you, very much indeed for getting through a wide range of issues for us. Thank you.

Examination of Witnesses

Witnesses: Paul George, Executive Director of the Professional Oversight Board and Director of Auditing, Financial Reporting Council, and Dame Barbara Mills, Chair of the Professional Oversight Board, Financial Reporting Council, gave evidence.

Q442 Chair: Thank you very much indeed, both of you, for joining us. For the sake of our records, could you indicate who you are and the organisation you represent?

Da e ar ara Mills: Yes, I am Barbara Mills, I am the Chair of the Professional Oversight Board and I am on the Board of the Financial Reporting Council.

Pa l eor e: My name is Paul George. I am the Executive Director of the Professional Oversight Board and the Director of Auditing within the FRC.

Q443 Chair: In terms of looking at the expertise of your organisations, under what circumstances has the FRC inspected local authority audits and how many inspections did you carry out in the last financial year?

Da e ar ara Mills: What, the audit unit?

Chair: Yes.

Da e ar ara Mills: Yes, about 100 last year.

Pa l eor e: The 100 is the number of audits we inspected in the private sector. As far as the work of the Audit Commission is concerned, we have been doing some work monitoring the quality of their work for the last four years. That is an arrangement that we have entered into with the Audit Commission voluntarily. They wanted to benefit from the same type of monitoring inspection that the private sector was subjected to. We do a combination of monitoring activities. We focus only on the financial statement audit; we do not get involved in some of the other aspects of their work. We look at their overall quality control procedures, to make sure that they have systems and procedures in place to ensure that they have a reasonable chance of delivering a high quality audit and then we look at how those procedures are applied on individual engagements.

The number of engagements we look at has depended from year-to-year. In the initial years our focus was primarily on what we call the firm-wide procedures, the internal quality control. We then review a small sample of engagements, both engagements that they conduct directly themselves and also some engagements that are undertaken on their behalf in the private sector firms. We typically would look at somewhere between five and 10 engagements a year across those two.

Q444 Chair: In terms of the number of local authority audits, how many?

Pa l eor e: Between five and 10 each year.

Q445 Chair: Between five and 10. So why do you want to seek a greater role in an area where perhaps you have had limited experience in the past?

Da e ar ara Mills: I think we would start from the other end, if I might, which is we are mightily concerned, and have been very concerned for a long time, about the concentration of audit in the four major audit firms. What is happening now seems to us to give an admirable opportunity to get more competition in that world. Obviously we are mightily concerned by some of the questions that you were asking in fact about how the work is going to be
spread out, if I can put it that way, if the proposals go ahead. What we would not want to see is—actually, it is three of the Big Four and two other firms—the Big Three, if I can call it that, of the Big Four, enlarging their concentration, by virtue of the fact they have been there already they are going to pick up a lot of the work. What we would very much like to see is that the remainder of the work is distributed in a different way.

Obviously we have heard quite a lot about it just now, but one of the things I think that would be very helpful would be if the remainder of the work could go into a mutual, possibly, but possibly a partnership with another of the firms. There are two who have been involved already, as I say, but whether any of the other firms would like to come in. Because it seems an admirable opportunity to achieve something that we have been trying to do—rather unsuccessfully I have to say—for quite a long time.

What we would not like to see is the break up facilitate the Big Four or the Big Three getting yet more work in this field, because we think that would be very deleterious for competition. So that is our main interest but we are also interested in the NAO.

Q446 Simon Danczuk: I share that concern about the Big Four dominating the work that is available in local authorities post Audit Commission, but the question then is: how do we tackle that? How do you create greater competition?

Da e ar ara Mills: I think it is very difficult to change a market, let me put it that way, which is what it has been. However, I do think there is an opportunity here. Let’s look at the figures at the moment: that work would, as a unit, make it become the fifth largest audit firm. That is very big, and I think that there is definitely a possibility that another firm, who have already had interest in this, could well wish to join up with them or part of them. So that would create some more competition, not only in this field but generally, which is important to everyone because, if you look at the private side of things, after all it is the shareholders’ money; if you look at the public side, it is the public’s money and it is equally important that you should have competition throughout that.

Q447 Simon Danczuk: I am not hearing anything that is going to get beyond that. Your proposal then is that the Audit Commission and some of the staff there create their own company that competes with the Big Four, but that is not much better than the Big Four dominating it. How do we get beyond that?

Da e ar ara Mills: Five is better than four.

Simon Danczuk: That is what you are aiming to do because that is what you are saying you want to do?

Da e ar ara Mills: Yes. That is one way you could deal with it. Five is definitely better than four. If one of the four were to fall at the moment, for one reason or another, then you would be down to three, there would be a real—

Simon Danczuk: You are talking small numbers—

Da e ar ara Mills: Small numbers but big organisations.

Q448 Simon Danczuk: So that is all you hope to achieve, to go from four to five? That is the competition.

Da e ar ara Mills: That is one of the things we would like to do.

Pa l eor e: Perhaps if I can just add on that. I think that is very much the case in terms of the private sector, and we do see that the abolition of the Audit Commission does create an opportunity for increased competition in the private sector audits. I think your question, perhaps, was a little bit more targeted toward: how do you get more competition in public sector audits? I think that, clearly at the moment, all of the appointments are commissioned through the Audit Commission. They undertake 70% of the work themselves and then they allocate the balance of that work to appointed firms. At the moment the balance of that work goes to five firms. You asked a number of questions earlier on around the independence and how do you safeguard independence, but if you move the appointment process to a local level then you are likely to stimulate some competition.

What one needs to make sure, from the starting point, is that only those that are competent to do the work have the licence in order to conduct that work and I think there needs to be a process to make sure that there is adequate competency to start with. Once you have people who have the competency to undertake that work then one would hope that by moving the appointment process to local communities, that that could stimulate some competition.

So I think the competition issue needs to be looked at from two angles: first of all, the opportunity this creates for the private sector—and perhaps that is not your primary concern here—but also the opportunity to create greater competition for public sector audits. However, we need the safeguard within that that there is an appropriate level of competence before somebody is available to conduct that work.

Q449 David Heyes: I understood you to say that you have been advising the Audit Commission on the quality of their work for four years now.

Pa l eor e: Yes.

David Heyes: Was there any stage during those four years that you said to them, “The quality of your work is such that you face a serious prospect of being abolished”?

Pa l eor e: No, we didn’t. I think the discussions around abolition is not really one that we have—

David Heyes: It has been proposed partly on the basis of the quality of the Audit Commission’s work.

Pa l eor e: If that is the case then that is not something that we have been involved in.

Q450 David Heyes: You didn’t spot it coming?

Pa l eor e: I think what we have focused in on is providing reports to the Audit Commission on the quality of the work that we have seen. The Audit Commission has been very positive in responding to the concerns that we have raised and have put in additional policies and procedures in order to mitigate the concerns that we identified. What they have also done, which I think is great credit to them and is perhaps different to how some of the private sector
firms have responded to our comments, is that they have been very transparent in their transparency reporting, in their corporate report on an annual basis, of the type of issues that we have identified, but to answer your question directly, we did not say that, “As a result of these issues you are at risk”.

Da e ar ara Mills: I think we could say that it was rather a useful relationship for them because they came to us, which when you are a regulator is always a nice thing to happen as opposed to people being sent to us. I think they absorbed and understood what we were looking for and showed a great willingness to improve. That was gratifying. Not quite the relationship we always have. That was a very good one, and I certainly haven’t heard anything that is very adverse, let me put it that way.

Q451 David Heyes: What are the advantages of the oversight arrangements you propose, over and above those currently being delivered by the Commission?

Pa l eor e: Shall I?

Da e ar ara Mills: Yes, you deal with that. I will come in.

Pa l eor e: I think perhaps it comes back partly to the first question. We have not sought any additional responsibility as part of this process. We have engaged in a debate with the Department around their early considerations of what might happen, post the abolition of the Audit Commission, and it would be fair to say that we had some concerns that rather more regulatory burden was going to be imposed than we would perhaps seek to put in place ourselves. Therefore, we were very keen that any regime that emerged from these discussions was very proportionate to the risks associated with that. So we have sought to perhaps narrow down the degree of involvement of the FRC and, in particular, the role of the Inspection Unit within the FRC to only those entities that are of the greatest public interest.

Q452 Bob Blackman: Obviously, at the moment the Audit Commission will funnel work and make sure that the individual bodies that are doing audit work are controlled. The issue that you have raised is one of registering and licensing bodies after the Audit Commission has gone. Why should that process rest with just one of the professional bodies?

Da e ar ara Mills: We have been proposing the licensing of the audit for the public interest companies, so it should be licensing in the private and the public sectors. We think that that is rather important, because we have seen some cases in the private sector where a firm that is not properly equipped has been doing some of these audits. So we do want some sort of regulation. I absolutely back up what Paul says, which is: we do not want to have heavy-handed regulation, but once things are fragmented, as indeed these are going to be, then I think that you do need some proper oversight—is the way I would put it—of what is going on. Because once you have central control, or central standards, then they can be applied and seen throughout whatever organisation you are talking about, but if you have a situation, which is likely to happen, where you are going to have rather a large number of organisations, some small, some very large, then they should have some sort of regulation. Of course I was very interested in how much, and if in the same proportion, when the previous witnesses gave evidence. That seems to be absolutely essential.

We have been talking through, in many ways, the practicalities with the Department of how this can happen. Personally I think one of the most important things is that the audit committees are composed of capable people who are able to give proper consideration to what is being proposed, because there is going to be a bit of a circle between the appointees, the appointed and the audit committee.

Pa l eor e: At the moment in the private sector in effect there are four bodies that licence the competence of firms to conduct audits. In our evidence submission we used the term “one of the professional bodies”. I don’t think we would have any difficulty if it was more than one professional body, so long as whatever professional body undertook that function it undertook it with appropriate diligence and on a consistent basis.

Q453 Bob Blackman: One of the concerns will be that could potentially limit the individual companies that might come in and compete in this market. If it is only one of those professional bodies.

Pa l eor e: There is that potential risk. I think there are in the order of 8,000 firms of registered auditors at the moment, a significant proportion of those are registered with two of the professional bodies.

Q454 Bob Blackman: What criteria would you use in terms of determining who is going to do this licensing and registration?

Da e ar ara Mills: Sorry, I am losing my voice today, which isn’t helpful. Both professional bodies, the two big ones, have 80% of the members. I don’t think it will necessarily limit it, it shouldn’t. They should have some competencies that are applicable, irrespective of which body the person who is applying belongs to. I would not have thought it would act to shut people out, if that is the point you were making about that.

Bob Blackman: Clearly, it sets another hurdle in terms of people coming into this market.

Da e ar ara Mills: That is right. On the other hand, I don’t think you want to have too many because then you have the problem of standardisation, and it is likely that the two bigger ones are going to have more sense of the competencies you are going to have across the board.

Q455 Bob Blackman: So are they going to be funded to do this, and who is going to pay for this work?

Pa l eor e: At the moment they receive a licence fee, in effect from the firms that they regulate, and that is part of the cost of doing business, which ultimately is passed on to the recipient of the service.

Q456 Bob Blackman: You see that working in the same way for the public sector?

Pa l eor e: I don’t see any reason to have a different approach.
Q457 Chair: What has been put to us is that, while the Audit Commission is obviously going to go and the hands-on audit work may go off to some mutual organisation, which we have talked about, and the Commission won’t exist anymore, there is still this number of regulatory functions that are around. Wouldn’t it be helpful if those remained in one body to stop the sorts of fragmentation that we have been talking about?

Dame Barbara Mills: I personally would be in favour of it remaining in one body but I am not sure that is an option that is open at the moment. I would think it is much easier to do that through one body. Otherwise when you get down to the practicalities of this—and we have been talking quite a lot to the Department to try to help with the practicalities—in my view there are some serious problems. Mainly how you hold up standards and values and also how you have it properly supervised, monitored, whatever word you are going to use, throughout all these fragmented bodies. That I do think is a real problem. That is why we have been trying to help to point out the pitfalls but more positively to say, “Look, we think this might work or that might work” but it is obviously up to the Department, the Minister and the Secretary of State to decide.

Q458 Chair: Any ideas who that body might be? Would it be the National Audit Office?

Dame Barbara Mills: They are the obvious people to do it. They are all ready.

Q459 Chair: Finally, a question about the principles of public audit. You basically said that you were happy that public audit closely mirrors that which is carried out in the private sector. One of the current principles is that public bodies do not appoint their own auditors. You seem to be fairly comfortable with that changing. Is that the case or do you have reservations, or do you think they need to be safeguarded and, if so, just briefly say what they are? Just a final point.

Paul George: I think what we suggested in our submission was we supported the proposals that the appointment of the auditor—and this is obviously to safeguard independence—should be through an audit committee accountable to the local community that the auditor is there to serve. So I don’t think we were suggesting in our submission that it would be down to the management of a local authority to appoint the auditors, we were supporting the proposals that we had heard, that audit committees would be put in place in order to provide appropriate independence from management over audit appointment and audit quality type issues. We appreciate there are some challenges in that, and I suspect at the larger end of the market it will be relatively straightforward for a principal district council to find suitably qualified and experienced people to undertake an audit committee role. It might be more difficult the smaller the authority. Therefore, perhaps one needs to look at alternatives to ensure there is appropriate economies of scale, because if it is a very small organisation there is probably not a huge amount of work for the committee in those circumstances.

Q460 Chair: That is the sort of function that a regulator—one overarching body—could have some oversight over and maybe assistance with?

Paul George: That is a possibility, yes.

Chair: Thank you very much indeed for the evidence you gave to us. Thank you very much.

Dame Barbara Mills: Thank you. I am sorry we couldn’t help you further but our expertise is not really—

Chair: No, that focused on the points in question very nicely, thank you very much.
Monday 4 April 2011

Members present:
Mr Clive Betts (Chair)
Heidi Alexander
Bob Blackman
Simon Danczuk
David Heyes
George Hollingbery
James Morris
Mark Pawsey
Steve Rotheram

Examination of Witness

Witness: Amyas Morse, Comptroller and Auditor General, gave evidence.

Chair: Good afternoon.
as Morse: Good afternoon.

Q461 Chair: Welcome to our final session on the audit and inspection of local authorities. For the record, could you introduce yourself and say what organisation you represent?
as Morse: Certainly. My name is Amyas Morse. I am the Comptroller and Auditor General. I am also in charge of the National Audit Office.

Q462 Chair: Thank you very much for joining us. For the sake of clarification at the beginning, could you tell us whether you’re here this afternoon expressing personal views, or has any formal position been taken by the Public Accounts Commission, to which I understand you report on these matters?
as Morse: I report to the Public Accounts Commission for funding purposes, so I’m not here expressing a view that it might take.

Q463 Chair: So you’re simply expressing a personal view at this stage, in your capacity as Comptroller and Auditor General.
as Morse: That’s right.

Q464 Chair: The Government made their announcement about the abolition of the Audit Commission on 13 August. Were you consulted about that beforehand or did you learn about it from the media, as I did?
as Morse: I was aware of it shortly beforehand, yes.

Q465 Chair: Aware but not consulted?
as Morse: In a way consulted, in that there was some visualised role for us and obviously we were asked whether we were able to carry out that role.

Q466 Chair: But the consultation was purely—specifically—on that narrow issue about the possible role for the National Audit Office?
as Morse: It wasn’t on the policy issue.

Q467 Chair: Have you had discussions subsequently about the particular role that the National Audit Office might perform with the Secretary of State or the Minister?
as Morse: I have only met the Secretary of State once, the day before the announcement, but my team, mainly, and I from time to time, have met officials.

My team have played a part in a steering group where the Audit Commission was also represented and have regularly met officials, talking about the shape of the consultative document and how all that might be organised.

Q468 Chair: I understand there may be particular roles for the National Audit Office to perform, but as the person who might be seen as the country’s senior auditor, you must have a view about the whole approach to the abolition of the Audit Commission and whether the decision was taken in line with the arrangements for best audit practice and value for money.
as Morse: Just for a moment, if I may, I’ll explain why I haven’t given you a written submission or anything of that sort. It’s because I’m an Officer of Parliament and, in order to do our job, we very much are enjoined not to get involved in policy and political issues, so normally I would not want to be on either side of a debate. In this case, it was pretty clear, as soon as we became aware of this, that it was a policy-driven decision. It wasn’t a question of merit or demerit. Then if I add my private comment to that, while I have a lot of respect for and good relationships with many in the Audit Commission, I think that both the Audit Commission arrangements have pluses and minuses to them and, as a matter of fact, I think that the proposals being put forward are also practicable—different but practicable.
Chair: Okay. We’ll probably explore those in a little more detail as we go along.

Q469 George Hollingbery: I am intrigued by the idea that this was a policy-driven decision. It may have been a decision taken in isolation from evidence by the Secretary of State. Does that make it policy driven?
as Morse: What it means is that, as I have always understood it, it was to do with the consideration of wanting to decentralise the arrangements—not to have a large Government body running them and so forth. I took that to be a policy-type decision. I didn’t understand it to be a scorecard; I understood it to be a decision to have a different set of arrangements.

Q470 George Hollingbery: As a matter of interest, let’s say that the Secretary of State had come to you with a question about value for money, about how much was being spent, about efficiency and about what the Audit Commission had done and had
produced. Did you have any evidence or research that you could produce that would have told him about that?

**as Morse:** I would have only had evidence of what I had been able to observe, which wouldn’t have been systematic.

**Q471 George Hollingbery:** So no systematic undertaking of any research by the NAO on what the Audit Commission had done in its how many years of auditing?

**as Morse:** We are auditors of the Audit Commission, so we’ve obviously audited its accounts and to some extent we look at that, but that’s a different question from, leading up to this decision was some evaluation done? No.

**Q472 George Hollingbery:** So not on its effectiveness or efficiency at all. You had done nothing of that sort. You had not undertaken any Audit Commission-type review of the Audit Commission?

**as Morse:** Have we prepared some una nnounced report on our evaluation of the efficiency of the Audit Commission? No.

**Q473 Mark Pawsey:** With regard to the audit of local authorities, which is the issue we’re investigating currently, does it matter if the auditor is appointed by the local authority? In your view, would that make the auditor less impartial than if he was appointed by the Audit Commission, as has been the case?

**as Morse:** The independence of the auditor is very important and is one of the fundamental principles of public audit, which we support. I think it’s quite practically achievable to get independence of appointment through arrangements that involve having an audit committee with strong non-executive and external elements in it. I think it’s achievable to get a suitably independent appointment through that means. The reason I think that is that I’ve seen it quite a lot in the commercial world and therefore I’m not amazed by the idea that you could do it.

**Q474 Mark Pawsey:** But does the audit of a Government body necessarily have to be carried out by a Government organisation? Is it appropriate for the audit to be carried out by a private sector body?

**as Morse:** It is a question of the quality and the surrounding buttressing, not of the inherent nature of whether the body is private or public.

**Q475 Mark Pawsey:** Would you say that there is no reason why a private sector body should not be capable of auditing a local authority?

**as Morse:** No, I cannot see an inherent reason why.

**Q476 Chair:** You are absolutely certain that the measures, as proposed, can safeguard the independence of auditors? That seems absolutely crucial.

**as Morse:** Let me, Chair, be as clear as I can. Like many things, it is not a question of what is being proposed. Can it possibly do it? Yes, it can. The question is, will the safeguards be put in place and will they be enforced rigorously? In other words, it is as much about implementation as about concept, and, actually, the implementation needs rigorous attention. So, yes it can be done, but it needs a strong approach, not just a bit of lip service to it.

**Q477 Chair:** This is a fundamental change, isn’t it? Going back—well, as long as anyone can remember—local government and councils have not appointed their own auditors. I think that the last major look at this was the Layfield commission, which recommended that that principle should stay. So, this is quite a change of principle, isn’t it?

**as Morse:** The principle is independence. I have thought carefully about this, because I guessed that you might ask me these questions—and quite rightly, too. In my view, the question is, is the appointment independent? That is the question. It is not a principle that it must appointed by a public or an external body. If you get the right arrangements in place, I believe it is possible to get independent appointment, because through the consultation process we could come to a viable set of independent appointment criteria.

**Q478 George Hollingbery:** What is your recommendation to the Committee for ensuring that this is an independent process? Is it statute? Is it direction from Government? How does that work? As a new MP, I am afraid that I am not familiar with the potential processes.

**as Morse:** First, there is a proposal that it should be compulsory that there be an audit committee. If you do not have an audit committee and you don’t have it also laid down on a statutory basis that there must be a significant balance of independence in the appointment activity, setting aside what you might do for the rest of the audit committee’s supervisory activities, I think it is essential that, for the appointment activity in particular, there must be a very clear, demonstrable independent majority—that would be my view, personally—to be sure of getting independence.

As we go through the debate, it may be possible to buttress that further and further, but it is important that it be clearly demonstrable that that committee does not have a majority of those involved in the council in detail for that function. If you get it right in that way, it is feasible to have demonstrably independent appointment. That would be my view.

**Q479 Mark Pawsey:** How would you enforce that? How would you make sure that that happened?

**as Morse:** If you have a clear set of duties on the audit committee, and they are clearly set forth in statute, you are in a position where it is a public duty that is either carried out or not carried out. There are clearer responsibilities and they can be called to account by the Department, or whichever body is nominated.

**Q480 Mark Pawsey:** So you would enshrine it in law, rather than leaving it up to the individual local authority to decide what is best for them.
as Morse: Yes. I do not think it should be open to them to decide what is best for them in matters of independence of that kind.

Q481 Chair: May I take this further? You talked about independence of the audit committee, but as I understand it in the Government's consultation document the audit committee would not have a veto over the appointment of auditor and, probably even more importantly, would not have a veto over an authority's decision to sack an auditor. Is that something you would want to see strengthened?

as Morse: Forgive me, Chair, but I am going to keep on saying that, rather than picking individual pieces of the arrangements, we have to be satisfied that the overall result is that this is an independent appointment process. So, whatever the combined elements that are put together as we go through consultation and go towards finalising the proposal, what has to be absolutely clear is that it is demonstrably independent. That, I would say, would be true whether we were doing that or whether we were looking at unchanged arrangements through the Audit Commission. You have to be able to demonstrate independence of appointment.

Q482 Chair: If the final decision rests with the whole council, which is the council effectively being the auditor, will that process be demonstrably independent?

as Morse: As you have described it, I would not be automatically sold on it. I would be looking for something that had a strong external voice in the appointment process.

Q483 Simon Danczuk: Are you comfortable with the new responsibilities that the Government are proposing for the National Audit Office following the abolition of the Audit Commission?

as Morse: Largely, yes.

Q484 Simon Danczuk: In terms of the capacity and skills within the National Audit Office, do you think that it is capable of delivering what is required?

as Morse: For the most part, yes. There may be some specialist skills that we need to have. We would not say that there is nothing we should learn, but as we sit here, yes, I think so.

Q485 Simon Danczuk: There has been a big debate about savings around the abolition of the Audit Commission. Do you expect some funds to be transferred from the Audit Commission to yourselves or do you expect to deliver it all within your existing £95 million annual budget and 900 staff?

as Morse: First, I would not want to receive any funding from the Government. I am funded by the Public Accounts Commission, and I have been very open with it. So far, I have not asked it for any additional money, because I did not know exactly what we would be asked to do, and I still don’t. Once we get to the end of the consultation process and these matters become firm, I will go back to the Public Accounts Commission if any additional funding is required. It is certainly not my ambition to have any material change in the size of my organisation as a result of this, but obviously there may be something that I need to do.

Q486 Chair: May I pick up on one phrase you used? It is worth me trying to dissect the answers just to dissect the accounts. When you were asked about the capacity of the National Audit Office to carry out the suggested work, the word “largely” came in.

as Morse: I am only being prudent. It is not because I have some special secret flaw in mind. We deliver a substantial number of studies that take account of local delivery. However, if there are a significant number of things you are being asked to do—which, on the face of it, you think you can do—it would be a bit foolish to say that there is nothing else that you need until you have precise responsibilities and understand the task properly.

Q487 Simon Danczuk: Does that not make it difficult for the Government to predict what sort of savings they are likely to make? They have been talking about £50 million a year savings. How can they reach that figure if they don’t know what funds you may or may not require?

as Morse: The amount of resources that I would require for this would be quite marginal. I am just trying to avoid making a statement that I regret later on.

Q488 George Hollingbery: I ought to know, but don’t know, where your funding is derived from and where it is voted from. Can you tell me exactly?

as Morse: I am going to get this right, so I may have to turn round to my team. We propose a budget to the Public Accounts Commission. It is voted directly from Parliament, so it is a direct vote, and you will see it as a separate line in the requisitions of the parliamentary vote. We propose a budget every year, and we appear before the Commission twice yearly—once to propose a budget and once to report on how we are doing. We are quite tightly controlled. For what it’s worth, we are in the process of reducing our costs by 18% over three years.

Q489 George Hollingbery: But it is a fine matter, is it not, to contend that your money does not come from the Government? It comes directly not from Government, but from Parliament, and therefore the taxpayer. Ultimately, that is correct, is it not?

as Morse: That is absolutely correct, but it is not a fine distinction but a very significant distinction. Neither Ministers nor officials have any say in the amount of our funding. I am asked by the Chair, “Have you got the funding you need to do the job properly?” It is up to me to say yes. I have proposed that we make a reduction in our budget, primarily because I don’t want to be in a position of looking at and reporting on colleagues in the civil service, and looking as if we are not practising what we preach. I wasn’t invited to do that by the Commission. So, to be clear, it is very careful not to do anything that could be construed as interfering in our ability to do the work we need to do.
George Hollingbery: That’s a useful distinction. Thank you very much.

Q490 Simon Danczuk: May I ask a quick supplementary? So that I am clear, is it not Parliament that should determine the expansion of your responsibilities, or is it the Government and Ministers?

as Morse: That’s correct. I didn’t answer properly. I have a clear understanding with the Public Accounts Commission that, before I commit to any additional resource or activity, I will seek its agreement.

Q491 James Morris: May I press you a bit more on the capacity of your organisation to take on the role, for example, of producing the audit code of practice? Doesn’t that imply a high degree of specialisation and skill? You said earlier that you didn’t evaluate the effectiveness or value of the Audit Commission’s work; you were merely the auditor. Isn’t this a very specialised area? The Chair referred to your word “largely”. Isn’t it understimating the scale of the task of taking on this new function, because it implies detailed knowledge of how local government works, which your organisation doesn’t have?

as Morse: We have people who have worked in local government, and we’ve taken care to have more of them, so we have experienced people who can be directed at that work. If I wasn’t confident of that, I wouldn’t be saying this. But there is a reason for having a fairly fluid community. We have people with significant local government experience already.

Q492 James Morris: You don’t envisage this costing you any more? Do you have an estimate?

as Morse: It may do, because we’re doing something we don’t do now, so there is a certain amount of time to allow us to see that we’re doing it—

Q493 James Morris: Do you have some estimate of what you think it will take to take on that particular role?

as Morse: No, but I am talking about relatively small numbers.

Q494 James Morris: When you say “relatively small”, what does that mean?

as Morse: Okay. Setting the standards and, more importantly, consulting with local authorities about standards, which, by the way, I regard as crucial to this—

Q495 James Morris: There are quite a few local authorities to consult with.

as Morse: I don’t have an estimate, but I think it is a few million a year, not more than that. If you want to know what a few is, it is less than five. Is that all right? I am trying my best to be clear.

Q496 George Hollingbery: I am sorry to return to the previous question, but Mr Danczuk has stimulated another question in my mind, and again it is a fine question. If you take over a role, you are not part of Government budgets. Is that correct? You are part of parliamentary budgeting, not part of Government budgeting.

as Morse: That’s right.

Q497 George Hollingbery: Therefore, anything you take over from Government is automatically a reduction in Government spending, and becomes someone else’s problem. Is that correct?

as Morse: You may take that view, sir.

Q498 Heidi Alexander: Under the fragmented local audit functions that could exist in future, I wonder how confident you feel that you will be in a position to provide assurances that public money is being properly spent.

as Morse: Well, apart from auditors, local authorities have something to say about that. I believe that it’s feasible for us to talk about the focus of audit, which will be governed by the practice guidance to some extent, and to ask whether, in the opinion of the local authorities and in our opinion as the appointed auditors, it focuses sufficiently on the issues that really matter, even at the moment, and whether it could focus better on them. I don’t believe that the only possible outcome of the change is that things could get worse. For example, you could focus more on the processes for establishing value for money through good governance statements, rather than through VFM activity. You could do VFM work when there is a project or a reason for examining value for money. In other words, it might be possible to have something rather more targeted that looks more deeply at budgets and things of that sort.

That is something that, in dialogue with local authorities, was seen to be very valuable, yet, on an objective basis, we felt we could support. If different firms were applying that code, you would have to make sure that they all understood the code, and that the authorities understood it and were making sure it was being applied properly. That is not a difficult task.

Q499 Heidi Alexander: There are quite a number of changes in terms of the provision of future services. The Government talk a lot about making sure that different providers can get involved in the provision of local authority services—whether that is community, voluntary or third-sector organisations. There has been a lot of talk about community budgets and the reduced audit requirements for smaller bodies. In light of those changes and the changes to the audit regime, what is your thinking on the overall assurance that you can give about the expenditure of public money—whether it is value for money and whether it is being used in the best way possible—given your national responsibilities?

as Morse: You are quite right to talk about my national responsibilities, which are primarily to Parliament, to follow taxpayers’ money and ensure that we have reasonable assurance that it is being used efficiently and effectively and that it is being applied as intended. You are right about that. Some of the changes on localism have nothing to do with what is happening with the audit arrangements. If you look at some of the proposals for community budgets and so forth, what they hold out is an opportunity in some
cases for the more efficient use of resources. If there is enough information for those who are carrying out the activities to be in reasonable management control of them and know what’s happening—what’s being done with the resources and what’s being delivered—there should be enough information to get assurance on it.

I am not appalled by the fact that there may be different and more flexible models locally. It is possible to obtain assurance on those just as much as if you have a very formulaic model. It is possible to do so, yet you need to adapt to that. Auditors are capable of and used to adapting to that, so it can be done. If I can add to that, the important point is that the audit approach should focus on what really matters in a particular area. If nothing much is happening and you have a fairly simple set of services, the main issue is, as pressure comes on in terms of the scale of funding that you’ve got, the main focus should be on the adequacy of budgeting and on the financial sustainability of the body. If there are no major projects and nothing much is going on that needs to be examined for value for money, perhaps we should allow ourselves to focus our efforts on where the action is. That is not a bad way of going. It is a slightly more flexible approach that involves focusing on what really matters in a particular local authority.

Q500 David Heyes: In the consultation papers, the Government envisage an NAO role in value for money studies in local government, which is work currently undertaken by the Audit Commission. Is that another area that you feel largely comfortable about in terms of your ability to undertake it?

as Morse: In many ways, the Audit Commission does a good job on that. However, to be clear, it is not territory that is unknown to us. I shall just name a few of our many studies on services and local delivery. In the past year or so, we have done work on tackling the problems of drug use and seeing how that impacts locally. To take another example, we have looked at how people with autism are supported and how that works through different communities. I have about 20 such examples.

It is not as if all we ever do is look at central Government activity. We’re quite accustomed to looking at applied programmes to see how they have worked. I believe that there’s quite a lot we can do to help as we take up this role. In particular, I think we’ll be able to look at how cost reduction is being carried through, and how it is being managed. We’ll look at financial resilience across the population and at different delivery models.

It is interesting to look back from local government at central Government and see how heavy a burden central Government place on local government and how they interact with it. We’re already developing a study at the moment on whether local government gets a huge volume of communication, different guidance and directives from central Government, and whether there’s a more organised and more cost-efficient way of giving that guidance that doesn’t place the same cost burdens on local government.

Q501 David Heyes: Indicative figures suggest that the Audit Commission spent about £5 million last year on 20-odd value for money studies. That’s the kind of work that I guess you’re expected to take on. If it cost £5 million to conduct those studies, it will be a considerable demand on your current resources. Is it something that you’ll be able to do?

as Morse: We do 60 reports a year at the moment. We’d have to assess how much we could fit in with the scope of our existing capacity, and to what extent would we need any new resource to do that work.

Q502 David Heyes: Would your approach to this produce a lower or similar average cost per report?

as Morse: I haven’t made a comparison. The cost of our reports is going down as we get more efficient.

Q503 David Heyes: Indicative figures that we’ve seen suggest that the Audit Commission reports typically cost half of what the NAO’s value for money reports cost. Does that sound familiar to you?

as Morse: That may well be; it’s a question of what you do in writing the report. While they are valuable, many of the reports that the Audit Commission is doing involve comparing information that is already available on a number of local authorities, whereas our value for money reports mostly involve going in and investigating large projects and programmes, which entails a great deal of investigative and research work. In many cases, the reports are different types. If you look at the average cost, it’s not strictly comparable. My idea of it is that some of the work that we already do could quite reasonably be redirected into doing these projects.

Q504 David Heyes: I guess that the Local Government Association has a view on this value for money work. Have you discussed this with the LGA?

as Morse: Yes.

Q505 David Heyes: What was the gist of those discussions? What was the outcome?

as Morse: It was interested in these systemic, value for money reports.

Q506 David Heyes: Does it value them?

as Morse: Yes, it does, and it’s clear to me why. We’ve done a bit of work to try to understand it. I’ve personally visited two or three local authorities and met the Local Government Association to try to get some understanding of its views. It’s clear that the LGA regards these wider systemic reports that allow people to draw comparisons as in some way valuable.

Q507 David Heyes: Has it voiced similar concerns to what was inferred by my question—that you might not have the capacity to continue doing the same quantity or quality and depth of reports that the Audit Commission managed to do in the past?

as Morse: It hasn’t expressed that. Frankly, I’m not feeling worried about that.

Q508 James Morris: May I ask one specific question? It may be slightly tangential to value for
money, but in answer to an earlier question you said that you have never done an evaluation of the efficiency or otherwise of the Audit Commission. Then you talked about wanting to understand about costs and central Government’s interaction with local government. Has any work been done that’s identified the cost of compliance for local government with the requirements of the Audit Commission or any wider agencies? In response to the Lyons inquiry, the National Audit Office estimated that the cost of compliance for local public bodies is somewhere in the region of £2 billion. Is that a number that you recognise?

Q509 James Morris: It’s quite surprising that the National Audit Office hasn’t done any systematic work on that, because the cost of compliance is critical to value for money for central Government. If you evaluate the cost of compliance, there’s huge scope for saving there. Isn’t it quite surprising that it hasn’t done that kind of work?

as Morse: The fact that I don’t doesn’t mean it’s not true. It may just mean that I haven’t covered it in my preparation for this.

Q510 George Hollingbery: To develop the line of questioning a tad further, you’ve had some fantastic results, frankly, in the financial impacts that you’ve achieved. We understand that £890 million in financial savings has been made—mostly cashable, as far as I can see—across Departments. The Audit Commission itself doesn’t have any figures on what it might or might not have saved across its remit, but it says that with spending of £200 billion, if 1% in savings is achieved, it is clearly worth while. Do you think the NAO will be able to achieve similar levels of success when examining local government in its value for money studies?

as Morse: What we will be doing in terms of direct examination will be only on studies across local government, so I really couldn’t make any prediction on that. It should be that if we draw lessons out of such studies generally—they affect a lot of local authorities, so they should be of considerable value—of course that value only comes if there is action on them.

In our work on central Government, in addition to agreeing the value that has come from our work with the Departments concerned, which is where we get our figures from, we also review very closely whether or not, when there’s been a report and recommendations have been made and accepted by a Department, the Department then carries them out. In many ways, I regard success in identifying issues as when a Department does something, moves forward and improves capacity. We really think that’s the most important measure of success—not that it should necessarily do exactly what our findings say, but that it does something that ups its game in that direction—because we know we’re having a beneficial effect. There is a surprisingly high correlation in that area.

Will we be able to do that in local government? Will we be able to find correlations like that? I hope so, and I am optimistic we can have a positive effect, but you might find that the Audit Commission could have done just the same, if it had correlated the evidence in that way. I’m not assuming we’re going to be miraculously better than the Audit Commission.

Q511 George Hollingbery: It’s quite an interesting juxtaposition. I have in my head the idea of your being internal audit for national Government. That is a truism, I guess; that is what you are, ultimately.

as Morse: We are not just internal audit. We actually carry out the formal audit of the accounts. That is to say, we give an opinion on a true and fair view of the regularity of the application of the funding and the statement of internal control signed off by the accounting officer. We also do value for money reports on Government. The value for money piece of our activity is the one that’s closest to an internal audit.

Q512 George Hollingbery: I remember receiving, as a little tiny councillor, lines saying, “Action: has it happened?” and so forth. The reason why I bring that up is that it occurs to me that, to take it down the scale into local government, there are only so many themes that are really large enough at your level of examination to register on your radar. Therefore, it seems to me that there is a potential gap between what you can provide at that level and what internal audit can provide at the local council level. Is there not, potentially, a gap in between, where there may be a scale of activity that isn’t examined?

as Morse: I am fascinated by trying to improve the efficiency of what happens in the public sector. If we find there’s a gap, we’re not going to just sit and look at it; we’ll find some way of working with the local authorities to see that it is addressed. I don’t mean that that will necessarily be done by us, but perhaps it would involve looking at the remit of the local auditors, providing the auditors with better information as to what they should be looking at or making sure that we join up tightly with them. If these proposals go into statute in the form that they are now, I would certainly take that view—a positive, developing view.

Q513 George Hollingbery: I’m very attracted by that proposition, but do you believe that the consultation and your proposals, as they stand, give you that authority to make different arrangements from those that currently exist out in the field?

as Morse: I think it’s feasible, through the guidance arrangements that we have, that we could do that. Through the proposals, I think that’s feasible. There’s an opportunity for regular discussion and consultation, which, I hope, would let that happen.

George Hollingbery: And potentially lead to solutions that are local, but inspired by national guidance.

Q514 Simon Danczuk: Some 20% of your audit is done by private sector auditors and 30% of the Audit Commission’s work is done by private sector auditors,
and that’s going to dramatically increase according to the Government’s proposals. Why is your figure so low? Should the amount of private sector audit work not increase?

_as Morse:_ That is a perfectly reasonable challenge. Our percentage is low, because we use the private sector to supplement what we do. For completeness of disclosure, it’s probably becoming even a bit less, because as we work more efficiently and use our resources better, we find it cheaper to work our in-house resources. So, quite honestly, on the one hand, that’s true. Why don’t we propose to use the private sector more and act, effectively, as a commissioning house, which is a model that you could say should be there? In our case, with central Government, we’re talking about quite a restricted number of very large Departments. Without a substantial degree of continuity all the way through the Departments and an awareness of the issues that run through them—you’d be amazed how we find the same issues occurring again and again in central Government, with people not using information properly, not knowing what things cost and not having strong enough financial management—we wouldn’t be able to identify all those issues and see how they run through those very large Departments and through the non-departmental public bodies that they set up and run. I’ve asked myself that question, because it’s a perfectly fair challenge. I genuinely think there’s a big difference in kind between auditing central Government and auditing devolved local government.

**Q515 Simon Danczuk:** The history of the Audit Commission shows that it took on more roles and responsibilities and a greater work load as it developed, to the point where it was seen as unwieldy and had to be abolished—that’s one story. Are you not worried that that’s what’s going to happen to the National Audit Office?

_as Morse:_ My primary role is working for and with Parliament—I don’t lose sight of that for one minute. I’ve been very careful to state that as my primary role here. If you think about it, we’re very careful in what we say we’ll do. I really believe in what we do for Parliament. We need to see strong local authority audit arrangements, and we’re prepared to play a part in that, but I’m trying to stay to our primary function of supporting Parliament in holding the Executive accountable. If I thought anything that we were proposing might take away from that, I would be strongly against it.

**Q516 Chair:** Can I pick up on one point there? You were explaining the benefits of having one organisation audit across Government Departments to pick up the same problems and issues, and then you said that that doesn’t really apply in the same way to local government. But those of us who know local government would say that exactly the same problems and issues come up from one council to another, so you could have learning across the piece.

_as Morse:_ Yes, I can understand that may well be true, but I would simply say that, in central Government, these are actually the same organisation. You get a lot of issues in, say, the Ministry of Defence or the Home Office, some of which are cross-Government issues, and we draw those out. Many are particular to the particular Ministry, but common across all branches of that Ministry. If you’re in the Department for Transport, it’s really valuable to understand what’s happening across the spectrum of transport activity in order to do a good job.

**Q517 Chair:** You said at the beginning that you hadn’t been consulted about the principles involved in the Government’s decision, but if you had been asked at the beginning to design from a blank sheet of paper a system of audit for local government in this country, would it have been anything like that which the Government are now proposing?

_as Morse:_ That is a question that I am really not able to answer. It’s a completely hypothetical question. As I have said, I keep out of policy questions; I’ve never even allowed myself to think about it.

**Q518 Chair:** Right. Let’s bring you back to the world of reality then and look at the proposals before us. I’m sure you’re aware that the other day the House of Lords Committee that has been looking at audit in the private sector was very critical of the regulation of accounting and auditing, which it said was “fragmented and unwieldy with manifold overlapping organisations and functions.” If it is Government policy, as it is, to get rid of the comprehensive area assessments, get rid of a body having a commissioning role for the audit of local councils and get rid of a body nationally that does the audit of local councils, a number of regulatory functions are left and they have to be done by someone. Would it make more sense to have those regulatory functions done by one organisation, perhaps even the National Audit Office?

_as Morse:_ Thanks for the thought, Chair. What’s being discussed is that the Financial Reporting Council would act as the quality regulator on the auditors. It is, in my experience, a pretty ferocious regulator, and it is very experienced across the whole of the audit market in the UK. I know that, because we use it on some of our work, so I’m speaking from personal experience. For us to set up as a regulator would be a big new activity, and I don’t fancy starting from scratch on that.

**Q519 Chair:** Are there any dangers that there might be functions of the Audit Commission that the Government want to continue but which could somehow fall between the cracks of the various bodies that will be involved in this process in the future? Perhaps you will share with us things that you have concerns about and which you feel need addressing as part of the consultation exercise.

_as Morse:_ I understand that the audit practice is going to be mutualised, and I understand what’s to happen on the regulatory front, but I think it’s important that with those functions of the Audit Commission that aren’t going to go somewhere else—the elements that may remain—which are, in my view, mostly Executive activities of Government, such as
the national fraud initiative and possibly, if it were thought necessary, some sort of management of the audit market, it would be very significant to hear that the department really did have the capacity and the people to carry out those functions.

You’re quite right to say that in all these changes, we don’t want something to drop to the floor and we don’t want unnecessary risk to be taken. I understand and support that. I understand your question: I am just taking stock of that range of activities, and the ones that I’ve mentioned are probably the ones that don’t have a natural home and need to be taken care of by the department itself, which involves making sure that it actually has the capability and resources to do that.

I’m sure that it’s got the capability, but the question is whether it has got the resources.

Chair: Thank you very much for your time this afternoon.

Examination of Witness

Witness: Grant Shapps MP, Minister for Housing and Local Government, gave evidence.

Q520 Chair: Minister, good afternoon and welcome. May I say at the beginning, it was extremely helpful to have your consultation document, so that we had a chance to look at it before you came this afternoon? That was very helpful, and timely in its production.

The obvious question is, was it necessary to abolish the Audit Commission?

rant a s: We think that the Audit Commission had lost its way, I suppose you would say. It had itself become quite unwieldy, as a way of auditing local authorities. Things move on—it has done a good job in the past, but things move on and, with localism and transferring a lot of the power and responsibilities locally, we think that the right thing to do is to send some of the audit locally as well.

Q521 Chair: We have had quite a lot of evidence from a range of different organisations and individuals, and I think it is true to say that not many have come along and said, “Everything should remain as it is. The status quo should be kept.” But if the Government were intent, as they were, on getting rid of comprehensive area assessments and the Audit Commission’s role, and if Government had a view for localism, saying that auditors should be appointed locally and that that function should not be a national body, then what about the rest of the functions of the Audit Commission? Wouldn’t it have been easier to have left those with the Audit Commissioner as a regulator of the situation?

rant a s: One of the things that the Government have been very keen to do this first 10 months is to remove duplication and to cut through some of the bureaucracy. If you look at the role of the Audit Commission, it is quite an old-fashioned role. I have been reading some of the evidence from other witnesses you have had here, and one thing that came through to me, which perhaps had not done as much—even before reading what it had to say—is just how centralist the Audit Commission is. It is the regulator, the commissioner and, for the most part, it is the provider as well. There are not that many other spheres even of public life where we think that one organisation should go in and do all those things, let alone a sphere of life involving auditing, which is so transparent and open and has a proper market around it out there in the real world, with private companies being audited all the time, every single day. It seemed extraordinary that, in the end, we had settled on a system that was rather centralist. For those reasons, and many others, we thought that it was time to ensure that we can do this better, more efficiently, more locally, more transparently and with better value for money.

Q522 Heidi Alexander: Last week, you published a consultation on the future of local public audit. Why did you decide the fate of the Audit Commission before you carried out this consultation?

rant a s: Governments have to have a view on things. Ministers are there to lead—we have had these conversations in Select Committee before. We are put in place to take some broad decisions, and a broad decision, in our view, is something along the lines of, “It doesn’t make sense to have a national public body in control of the regulation, commissioning and the providing”, and we think that that could be done better, either through a mutualisation, more market competition or a combination. In any case, a lot of the work done by the Audit Commission is impacted in other ways by work done by other agencies. The National Audit Office is an obvious example. It produces the remit—the regime—within which audit takes place.

We think that the Minister’s role is to make the big headline decision, the consultation should decide the final outcome and we will publish a draft Bill, as you know, to ensure that Parliament has plenty of time to consult on it. I welcome the fact that the draft Bill idea has been welcomed by the Committee.

Q523 Heidi Alexander: So it was about grabbing a headline?

rant a s: No, not at all. It’s about leadership.

Q524 Simon Danczuk: When do you expect the Audit Commission to close?

rant a s: There is a process, as you know. The consultation—a full consultation—runs for 13 weeks, from last week when I kicked it off. We will then get the responses, and we will look at those through the summer. We will then draft a Bill to let Parliament take a proper look at this issue. I am pleased to have improved on some of the arrangements that were pointed out in at least one of this Committee’s earlier investigations into the code on local government publications. We try to work together to ensure that you actually get to publish your reports and then we can take account of them. We are doing it to the right timetable and we are sticking to our overall objective...
of doing this post-2012. Post-2012, we will find that audits are no longer being done in this centrist, top-down way.

Q525 Simon Danczuk: Post-2012? So that could be 2013, 2014, 2015, 2016 or 2017?

rant a s: If you are referring to some of the comments by the Audit Commission chairman in the weekend’s press, I don’t recognise that sort of timetable. I want to point out to the Committee that there could be a vested interest, of course, in extending the timetable, if you happen to be involved in the organisation. But we are very much pushing ahead with this process. The consultation is out there, the draft Bill is the next step and, as with all things in Parliament, you need to have the legislative slot to put the legislation through. So I can’t give you an actual date, but in our view the process is running on track.

Q526 Simon Danczuk: You are right, because the chairman of the Audit Commission has said, “The latest we’ve been told by officials is that they were looking at the latter part of 2014, possibly the end of 2014”. He went on to say, “If somebody gave me decent odds, I might have a small wager on 2015…it’s a possibility.” So you’re saying it will happen well before 2015, but after 2012?

rant a s: I saw that story, and I don’t recognise those timings at all.

Q527 Simon Danczuk: But you can’t estimate.

rant a s: I can tell you that we’re progressing with it in the proper manner, which is to put out the consultation document first. That document is out there. There’s no delay. The draft legislation will follow, once we’ve had a chance to look at the consultation responses and, by the way, your own report, which we are very keen to take into account. Then, as soon as we have a legislative slot, we’ll put the Bill in there. I don’t think any of that should take the kind of time scales mentioned in that weekend article.

Q528 Simon Danczuk: The reason why I mentioned it is that if you are going to abolish a large public institution, is it not reasonable for you to inform the public and, just as importantly, the Audit Commission about when you are going to close the organisation? Should you not give an estimate?

rant a s: We were very disappointed that it was the Audit Commission itself which chose to tell its own staff ahead of a formal announcement of these plans. I thought that that was very inappropriate. I absolutely agree with you that we want to provide certainty for members of staff. It would be helpful if the Audit Commission itself stopped briefing the weekend press on rumours and started to hear what we are saying as Ministers, which is we are moving ahead with the abolition of the Audit Commission to exactly the time scale that we had always envisaged. I would have thought that the fact that the consultation is out there, that we’re publishing a draft Bill and that we are doing this with due process in mind would have been welcomed by every parliamentary.

Q529 Simon Danczuk: Could it not be the case that the Audit Commission will now have to recruit staff to work to the timetable that you are suggesting?

rant a s: The Audit Commission will do whatever it needs to do to ensure that it can continue its statutory function; it is not for us to tell it how or when to do that. We try not to interfere, apart from when the Secretary of State blocked the £240,000 that was asked for the chief executive’s salary last year and apart from when we encouraged it to reduce its costs, which I am pleased to see it has done—at least it says it has done—by £11 million. It is not for us to tell it in precise detail.

It would help if the commission were not going around sending out smoke signals about varying timetables and spreading uncertainty. There is no uncertainty as far as the Government are concerned. In front of you there is the process. You know exactly what the process is. I don’t see what is to be gained—for the staff, in particular—from the chairman going around saying these things.

Q530 Simon Danczuk: My final question is this. One of the problems with your not being able to set a date by which the Audit Commission will close is that you cannot then estimate what the savings are. The Secretary of State initially estimated that £50 million would be saved each year. Does that figure still apply or are you revising it?

rant a s: Yes, no, very much so. In fact, I think that the deeper you go into this the more you realise that there are some really significant savings to be made through local audit and the additional competition that it provides, for example. As the Committee will now be aware, 20% is charged on every audit that is carried out by the Audit Commission as a sort of surcharge. As the Committee may also be aware, that 20% is charged when the Audit Commission sends in a private company to do the work, which happens in 30% of cases. It charges a 20% surcharge on that work as well.

I think that there are certainly much more efficient ways in which these audits can be carried out. If anything, the evidence since the initial guess estimates has been large and I certainly do not recognise some of the Audit Commission’s views. I see that it has said that there may be only £10 million to save or something like that. In fact, that might be representative of where the Audit Commission, which thinks nothing of spending £53,000 on designer chairs—some at £900 each—has got to, that it thinks that £10 million is just a drop in the ocean.

Q531 Chair: Can we have a note on the Government’s latest calculations of what the savings would be?

rant a s: Yes, it will be in the impact assessment when we publish the draft Bill, so we will give you chapter and verse at that time.

Q532 Chair: Is it not possible to have the information now?

rant a s: No. That work has to be done as part of the draft Bill. There are all sorts of decisions that are made in drafting the Bill, some of which will be
reflected on from the outcome of the consultation. You would not expect me to prejudge a consultation. You would not expect me to want to prejudge your own report. So we are very sensibly taking into account some of the feedback that we get from that before creating an impact assessment.

What I can tell you is that there is nothing that I have seen since the announcement of the abolition and the headline £50 million figure that leads me to suspect that the number is any smaller. In fact, the more you look into this, the more you see how money is being spent by the Audit Commission—£18,000 on bespoke photography for the launch of the report into the comprehensive area assessment, for example—there is nothing that does not lead you to think that you could save a lot of money by abolishing it.

Q533 Chair: There must have been some work done to arrive at the £50 million figure. So could we have that calculation?

rant a s: Yes. What is available is in the original announcement. We know that things like the overheads that I have described—

Q534 Chair: So can we have the £50 million figure broken down?

rant a s: The £50 million figure that we have already put out there is a headline figure. It was there when we said that we would abolish it. In outline terms, it includes things like the comprehensive area assessments, which have gone; the overheads—I have described how the commission charges a premium of 20% on audits both ways, even when it is private—

Q535 Chair: So there is a calculation that applies to that figure? Can we have that?

rant a s: It is a ballpark figure. There is no further detail that I can give you on that until the impact assessment, at which point you will get chapter and verse and all the detail that you could possibly want.

Q536 Chair: So the £50 million figure is not based on any detailed calculations?

rant a s: The £50 million figure was based on what we think it is possible to save. I have given you some very practical examples and I would be interested to hear these enormous salaries—

Q537 Chair: But Governments don’t make announcements about saving £50 million unless someone, somewhere in the civil service has done a calculation about which Ministers feel, “That’s okay. I can agree with that and announce it.”

rant a s: Yes. We think—

Q538 Chair: So can we have the figures?

rant a s: We think that if you look at the costs involved in the Audit Commission—these are costs that we talked about at the time. Some £28 million—

Q539 Chair: Can we just have a statement on how the £50 million was arrived at?

rant a s: I can’t give you more than is already in the top-line statement.

Q540 Chair: Today you can’t, but presumably there is something back in the Department somewhere?

rant a s: I think you’ve got everything you’re going to get on the subject. But when you get to the impact assessment, you’ll have chapter and verse on what can be saved each and every year. What I am saying to the Committee is that everything that we have seen subsequent to the announcement leads us to believe even more that there are some really big and significant savings to be made. We will be not at all backward in coming forward with that in considerable detail, but the correct time to do that is at the time of the impact assessment, when we can provide detail on the decisions that are being made as an outcome of the consultation and your own work.

Q541 Simon Danczuk: Is there a clear breakdown of the £50 million saving? The headline figure, as you called it.

rant a s: No. It is an estimate. We’ve said all along, “We estimate that there is £50 million.”

Q542 Simon Danczuk: But somebody calculated the estimate.

rant a s: The whole basis of an estimate is that you come to an approximation that you think is in the ballpark. In fact, as I have said, not only do I think it is £50 million, but from the work that has been done since, and depending on the way things shape up, it could be more.

Q543 Simon Danczuk: It’s a guess.

rant a s: It’s an estimate. We can go into the dictionary definition of an estimate, but when you make an estimate what you do is look at the costs, including the cost of things such as the comprehensive area assessment, the 20% that is charged to both sides of an audit, and so on.

Here is a very simple figure: the Audit Commission has a turnover of £120 million and it charges 20% on all its audits. There is a sum of money, therefore—it could be in the tens of millions—that we know is a charge made on its audits. We know that the Audit Commission was very top-heavy when it came to corporate administration—so much so that, now we have announced this, it seems to have managed to drop £11 million from its figures.

We know many such things and, by adding up those different elements, we come to a ballpark, an estimate. We never said that it is £50 million.

Q544 Simon Danczuk: But nobody added them up and the figure hasn’t been written down. Is that what you are saying?

rant a s: I just told you that the add-up is some £50 million. Are we going to go into detail on that? No. Are we going to go into considerable detail on what we think the precise saving, or a more precise saving, will be? Yes. The difference is that one is an estimate that we think we can achieve.

Q545 Simon Danczuk: Either somebody has written it down and added it up—in which case, can we have that list?—or they haven’t, so we can’t have the list. It is one or the other, isn’t it?
rant a s: It is written down in the press release announcing the abolition. I have given you some ideas about how the figure has come about, but you will have to wait until the impact assessment, which will give it in considerable, painstaking detail.

Q546 George Hollingbery: We shall move on from that clearly explained point. At least we’ve gone as far as we’re going to go on that one. I am interested to know the balance in the decision between saving money, which the Government have made quite a lot of, and the policy issues on how the Audit Commission works. Where is the balance in your taking that decision?

rant a s: We think that in today’s world it is an archaic system in which one organisation takes on all of those different roles and is, in fact, quite proud of the idea that it has become the fifth largest auditor in the land. That worries us. We don’t think that the role of the state is to challenge innovation and enterprise. Thinking that it is an achievement, as I was once told by the Audit Commission, to have become the fifth largest auditor displays an attitude problem at least. As I have explained, having the regulator, the commissioner and the provider wrapped up in one organisation is an inappropriate model of localism, transparency and the rest of it, for the 21st century. There is a principle that, from a public administration point of view, local audit would be a better way to go about things, but we also think that, as we have just explored in some detail and will go back to in much more detail in the future, there is a very large and substantial saving to be made each and every year by having a more commercially based audit regime.

Q547 James Morris: We were just talking to the National Audit Office, and it was quite a revelation that no work has been done to estimate the cost to local government of compliance with a top-down inspection regime or audit practice. The only time when the National Audit Office has made a comment was in response to the Lyons inquiry, in which it estimated that the cost to local government and local bodies of compliance was some £2 billion a year. Do you agree that that would be worth exploring further, not only in terms of potential cost savings from the abolition of the Audit Commission, but in terms of the cost to local government of compliance more generally?

rant a s: That is absolutely right. Stories may have to be written retrospectively on this—in five years, at the end of the Parliament as opposed to the beginning. At the beginning of the Parliament you still had comprehensive area assessments and different sources of funding. There were an enormous number of different variables pitched in. There were 90 to 100 different funding streams to local authorities, which had to be independently audited. Ministers had been sending them down the line to be spent on individual sums and so on and so forth. The 2006 report on mapping of local government performance said that up to 80% of officials’ time was spent answering questions to central Government with an enormous regulatory cost and burden attached. Although I accept that some of that had been removed—the Local Government Association thinks perhaps 25% of it had—that still leaves an enormous looking up, not looking down—or looking out, rather, to your residents as a regulatory cost to the local authority. You need to view the changes that we are making as not just being about a body called the Audit Commission, a conglomerate doing all these different things, but also about the job that we are asking to be done on the ground—this gets to the point of your question—which is much reduced. I can say to members of the Committee today that if that is not £50 million a year, I will eat my hat at the end of 2015, because it seems to me that there is enormous waste in the system.

Q548 Mark Pawsey: Minister, may we move on to consider the impact of the changes that will be brought about by the abolition of the Audit Commission? One of the key principles of public audit is the independence of the auditor, and of course that was ensured by having the auditor appointed by the Audit Commission. Under the new regime, there will be a strong audit committee. What evidence exists that, and can you explain how, local councils will be able to recruit and retain an audit committee of sufficient calibre and independence to ensure that that principle will be maintained?

rant a s: Sure. First, it is worth saying for the record that I do not think there is anything particularly spectacularly independent about a regulated commissioner or provider being the same body and often providing itself to do the work. There is nothing inherently independent about that situation. Secondly, perhaps it is worth explaining the kind of vision for this as we see it. First of all, the National Audit Office produces a code of practice answerable to Parliament. There is therefore a proper democratic independent approach to the auditing itself. Then we have the professional bodies regulating the auditors themselves, so it is not a case of having any Tom, Dick or Harry coming in to become an auditor. You have already got to be an auditor of some considerable reputation, which you would want to defend, before you can become an auditor doing this kind of work. Then the audit committees themselves, which you have alluded to, would have to be made up of more than 50% independent members, who are independent of the council. That means that they cannot be councillors, they cannot work for the authority and they would need to have an independent voice and oversight of this. So the intention is to set up a kind of good, solid but very transparent process so that everyone can see what is going on, and the independence is increased by not just having a largely monopoly supplier.

Q549 Mark Pawsey: Sure. But what evidence is there that local authorities will be able to recruit such people?

rant a s: About 80% of authorities already have some type of audit committee—not necessarily independent ones; possibly 50% could be classed as independent. I read some evidence to the Committee suggesting that there simply are not good people out
there who would be willing to come forward. That is not my experience in local government.

You don’t have to look far to see examples of all sorts of people prepared to pitch in and help their community. We think that there will certainly be people available and willing to do that in a spirit of public spiritedness. Also, of course, local authorities can share—in fact, it makes them more independent when they share their audit committee, if they want to do that, which potentially cuts down considerably on the number of people required to do the job.

**Q550 Mark Pawsey:** Even the TaxPayers’ Alliance saw some dangers in this relationship and spoke about the possibility of cosy relationships between public bodies and private companies. In light of that, would it be appropriate for there to be some kind of statutory framework?

**rant a s:** Sure. I am very sensitive to the idea that we end up with some sort of cozy relationship with the same auditors put back in place and again. We have specified probably five years and then we would reappoint it for one five-year term, which should be the maximum for any one firm, and the lead auditor could not stay in place for more than seven years.

We are certainly very aware and concerned to ensure that there are potential changeovers in the system. This is not all brand new stuff, because very large businesses in this country, and many smaller ones, have turnovers of over £6.5 million and are audited successfully by the private sector. I see no reason why the same should not be the case for a local authority.

**Q551 Mark Pawsey:** But there is a large number of local authorities, which vary massively in size. Under localism it is appropriate that the auditor is appointed locally, but there may be bodies that need some help and support from somewhere. Is that something that your Department might continue to do in future?

**rant a s:** Yes. You would still have the professional bodies, which are pre-selecting for you in the first place. Your field of choice does not include every auditor that you find on Google; it is companies that specialise and have been signed off to do that kind of work. So you know that whichever one you pick will be a company that is capable of doing the job.

At the moment, the Audit Commission acts as regulator and sets your price, whereas with this system, as with any other marketplace, the customer gets to choose who they go with and there has to be proper competition. That seems to be a perfectly obvious approach to buying services. Local authorities are well used to going out and competitively buying services—by the way, they could club together and buy them, too—so we have every reason to think that they will do so efficiently, which will help to drive down costs and increase the saving even further.

**Q552 George Hollingbery:** We are interested to hear what you have just said about the five-year limit or the seven-year limit, but the Comptroller and Auditor General has just been in front of us, and he was concerned that an independence of audit should be absolutely cast-iron insured. I got the impression—this is my interpretation, not necessarily exactly what he said—that he was looking for an independence of audit committee. Paragraph 3.6 of the consultation document relates to advice from the audit committee to a council; there is not an independence of audit committee to appoint the auditor itself.

**rant a s:** That is a very interesting point. People are elected to authorities to make decisions. This is similar to the original question, “What made you think you had the right to make a decision?” The answer is that you are elected. People can agree or disagree with your decisions. We think that councils and councillors are in the same position—they have a right to make that decision—but it becomes incredibly embarrassing and difficult if your audit committee on one hand says, “Actually, we disagree, and we are going to make a public statement of disagreement.” Again, sunlight and transparency would help greatly.

As you have mentioned, that is a point in the consultation, and the consultation is genuine—we are very interested in people’s views. We will be taking, among other things, the outcome of the Committee’s judgment into account before we issue that Bill, which is a draft Bill, so people will have a chance to see it in more detail. I am certainly sensitive to taking those views on board.

**Q553 George Hollingbery:** You gave a commitment to set the provisions about with rules in statute that ensure an absolute observable transparency and independence to setting who the auditor is on a regular basis.

**rant a s:** Absolutely. There is nothing perfect about today’s audit position if you still end up with a Doncaster, or what have you. Any system will have its shortcomings, and in the Government’s view, the best way to protect against things going wrong is for everything to be transparent. The disinfectant of sunlight, the transparency and the knowledge of the fact that the audit committee is not happy will put enormous pressure on people who are elected. But ultimately, we think that it is right that elected people are able to make decisions. One of the biggest changes that we are making with localism is to ensure that many more decisions can be made at a local rather than a national level.

**Q554 Chair:** I want to come back on the same point about the Comptroller and Auditor General, which is very important. Generally, I am very much in favour of localism and local councillors deciding things, but the audit of the accounts is something that requires a degree of independence. It is about not only the appointment, but the dismissal, of auditors, which is, in some ways, more worrying. If an auditor appears to be an inconvenience who is doing the wrong things, whatever the audit committee says, the council might be able to live with the embarrassment to get rid of the auditor. Should there then be consideration of strengthening the code of practice?

**rant a s:** We would, were it not for the fact that the auditors are regulated, their reputations are so important to them and you are not talking about
thousands or, potentially, hundreds of auditors involved in this marketplace. Essentially, any auditor who gets involved knows that their reputation is worth more than that individual audit, which is the check and balance on ensuring that any auditor who comes into place will be pretty certain to write what they really think.

Q555 George Hollingbery: The point is in reverse. If that auditor is doing precisely that, we do not want to see a council dismissing them because they are making waves.

rant a s: The trouble for the council, if it was minded to do that, which it shouldn’t be, is that not only would it have to overcome its independent audit committee exposing it, but the council would have to deal with the next auditor it chose telling it to do exactly what it did not like in the first place. The system is a pretty good check on itself. We will take the representations on that point seriously and listen to what you and others have to say.

Q556 Bob Blackman: On the point about regulation, you said that the Audit Commission has a multiplicity of roles. One of the concerns, which has been echoed, is that, potentially, we are into a very much more fragmented arrangement, with one or more professional bodies doing the regulation, the Financial Reporting Council doing a bit and the National Audit Office doing a bit. The one strength that the Audit Commission had was that it brought all that together. It seems as if it will be very much more fragmented and difficult for the public to understand how it all works. In your consultation, you seem willing to listen to ideas. I wonder where your mind is on that at the moment.

rant a s: Can I present this with a different direction of sunlight? We are simplifying what is a complicated situation. The idea that the public understand that the Audit Commission duplicates some of what the professional bodies are about is not likely to be, in the real world, a particularly well understood situation. Yet, that is exactly what happens. Doing away with the Audit Commission and letting the professional bodies be responsible for regulating the auditors is a simplification. At the moment, you have the professional bodies and the Audit Commission both regulating the auditors, of which there are only three or four involved externally anyway, which is the basic problem with the current model.

The new system will be very clear. The National Audit Office, answerable to Parliament, will get to debate its code of practice. The professional bodies will get to regulate the auditors and set the bar for how good you have to be to take on this kind of work, so that a council or audit committee—when they make a recommendation for an auditor—can be absolutely certain that any of those people will be right and that the differences will be more to do with fit and how much they will charge and so on.

That is a simple structure that most people will understand. After all, people do not say, “My goodness, it is incredibly confusing to work out which auditor to bring in.” I was in business for 20 years, and I was never confused about where to find an auditor or which one to bring in. We want to make this a bit more like the very successful audit that takes place in the private sector.

Q557 Bob Blackman: The one issue that will be different, which auditors will tell you, is that local authority and central Government auditing are different from private sector auditing. You could bring someone in, but as a local authority you may end up teaching them what to do to create the market.

rant a s: We want this to be a more level playing field. We think that the Companies Act 2006 provides a good basis for that. We understand that we are dealing with public money; there are not shareholders to hold the audit process to account. Instead, we need to have something in place, which is why we will have the code of practice from the National Audit Office.

If the NAO thought that something was systemically going wrong with the entire process, it would have a role. We think it is not enough that any chartered accountant can come in as an auditor. In fact, out of the thousands of chartered accountants, there will probably be only a much smaller number of firms that are capable of doing this work. We have many different levels of protection. The last thing I would want is to leave the Committee with the impression either that we don’t take seriously the need to understand that this is public money and that there isn’t the influence of shareholders, so there needs to be additional protection, or that we have not thought about and proposed to put in place steps every bit is good—and, I would argue, better—as the existing audit arrangements, which, after all, took a long time to uncover what was going on in Doncaster, to name but one example.

Q558 Heidi Alexander: May I ask you a very quick follow-up question on the discussion about the ability of full council to appoint or dismiss an auditor, taking into consideration, one way or the other, the advice of the audit committee? Given the very high tests that you talked about for spending public money, wouldn’t it be simpler to say that decision of the audit committee is final?

rant a s: The audit committee, in this sense, is a bit like a quango and it will take over some powers, which would otherwise be correctly exercised by democratically elected people directly answerable to the public. We like democracy a lot and we think that the public should have a much stronger hold on the people whom they elect, who should be answerable for the decisions they make.

This is one place where we can link back up the fact that I vote for someone as my local councillor and they have a duty to hold the auditors to account. The right place to do that is in full public glare in a meeting like this one—a full council meeting with the local press in attendance—to let the sunlight in. There is a judgment to be made on where decision making lies, but we think that, on balance, it lies with democracy rather than with quangos.
Q559 Heidi Alexander: Okay. I have a couple of questions on the future scope of local government audit. Four options on the scope of audit are outlined in the consultation. You were talking earlier about the importance of leadership and politicians saying what they think early in the process, so do you have a preference out of the four options?

rant a s: That is a cleverly worded question. No, I’m not going to prejudge the consultation. We’ve established that Ministers have concluded, just looking at the overall picture, that things can be done better, but I don’t want to prejudge the different options in the consultation now. There is enormous space for innovation in how things work. I was totting up a list of other people who could be involved if the information and data were out there and the audit was of the right size and scope to allow for involvement. We are all familiar with websites such as UpMyStreet, mySociety and TheyWorkForYou, and when any MP ever said to me, “Well, transparency surely won’t work.” I used say, “Well, how many constituents know about our voting records from TheyWorkForYou?” I am for ever meeting people who have gone online and checked out that kind of information. There are many other organisations, such as Openly Local and spotlightspend. There are lots of ways that openness can blossom. I am not sure whether I am getting to your question about scope.

Q560 Heidi Alexander: I am particularly interested in the value for money judgments that are currently included in the scope of local audit. Will you insist that they are retained?

rant a s: I am not an absolutist on this. Value for money is very important. This is technical work and it is difficult for a member of the public to go to those websites, or the many others that may spring up in future, and be able to crunch the data. We need to be careful about not ripping the whole platform away. Value for money will probably need to be one element. I do not think it needs to be as it was in the past. Local authorities would say, “Unless we set up this back office that says it’s checking off on every occasion, we’ll be marked down for not being good for value for money.” I don’t know how having somebody sitting in a back office checking off a form has any impact at all on value for money. We certainly don’t want a prescriptive version of value for money to go in place, but there is space for an audit to involve the value for money comments and questions.

Q561 James Morris: Is not one of the tensions with localism that 70% of central Government money will still be allocated to local government—and what happens in the resource review—but quite a complex picture is developing in terms of the interactions of different bodies on the ground? We are moving towards community budgeting and will have a much more diverse use of the social enterprise sector. Are there not challenges around making sure that the public money that is spent within that complex environment is properly monitored?

rant a s: First, I will comment on localism. Some people hear localism and assume that we mean that everything will be settled quietly locally, there will not be a problem and that’s it. So, the art of politics, which is the art of resolving conflicts through verbal reasoning, would suddenly disappear. That, however, is not the concept of localism at all. The concept is that people have arguments, debates and discussions, and come to agreements on a local level. I certainly don’t think that localism has any role, and nor should it, in trying to end debates. You are absolutely right that an existing conflict is that 70% of the money comes from central Government. We have declared our intention to try to move away from that system and we have said that we will do that in two different ways. First, a very good, early example of the way that we are working is what happened today. I issued a statement to Parliament saying that £200 million is being allocated, based on the new homes bonus. That is a very unusual piece of Government funding. It does not judge something from the last census and try to decide how many people in category A live in a certain area. Instead, it responds to decisions that have been made by the leadership of a local authority about how many homes are built, so people can have an impact on how much money they get as an area. Because of the distribution of that £200 million today, local authorities will now be going around saying, “Actually, we’d like to get a bit more of that next year, and we can do that by providing planning permissions and having those debates, and so on.”

Q562 James Morris: That is a really interesting description of the paradox, isn’t it? In that sense, in moving towards that world, isn’t there more danger in having a devolved way of accounting for that money?

rant a s: No, I don’t think so at all. A much bigger, potentially much more significant element than the new homes bonus is the review that is under way now into the financing of local government, full stop. As you know from the terms of reference, if business rates were kept locally, in an awful lot of cases, you would end up with councils that do not have to have big redistribution from central Government and that do not have to wrestle with all the different issues. You could, therefore, move to a world where 70% of funding isn’t from central Government, and then, of course, those decisions about what happens on the ground become even more relevant and much more localist again.

This is just not a free-for-all. In a way, I predict that this will be a bit like seat belt laws and perhaps even not smoking in restaurants, because when you step back and look at this in 10 or 20 years’ time, it will be extraordinary that the state ever employed a quango to regulate, commission and provide audit services. We don’t do it for private business, and it will seem extraordinary that we ever did for public businesses. It is just not necessary, and it is not a particularly competitive way to do things. Just because—to name two companies—British Telecom is audited by one private auditor and name-your-other telephone company is audited by another, we don’t think that that is a fragmented market. The market is actually very skilled at looking at both sets of accounts and then working out how those companies are doing respectively.
Q563 James Morris: Do you think that the private sector could have a greater role in auditing central Government in future?  

rant a s: There is a clear and sensible principle here, which is that wherever you can, you want to introduce competition into the marketplace. I am the first to admit that there is a difference between private and public, not least in the way that I was describing—the lack of shareholders and the importance of value for money and protecting taxpayers’ money, so the requirement to have checks is there. Nor is it the case that state checks—even at local government level, if you want to put it that way—won’t take place in the future. We will still have children’s services, adult social care and schools, so this is not perhaps quite as radical as someone seeing the subject anew might think. So, I don’t know. I wouldn’t want to predict the future direction. It certainly isn’t contained in today’s discussion.  

Chair: It could be that Ministers don’t want to upset the National Audit Office for fear of what might happen.

Q564 David Heyes: We know from your consultation document now that public bodies with expenditure of up to £6.5 million will be exempt from full audit—£6.5 million is the threshold that has been suggested. Collectively, that could be quite a significant amount of local government expenditure. Your consultation document says, for example, that at level 4—that’s bodies with expenditure between £250,000 and £6.5 million—there are 675 such bodies. Collectively, that has got to be a huge pot of money. Do you know how big it is? How big is that pot that you’re exempting?  

rant a s: There are two things to know here. First, that is in line with the private sector level of £6.5 million turnover. Secondly, only if expenditure is less than £1,000 does nobody ever come and talk to you—only then do you get no intervention at all. Between £1,000 and £6.5 million, as you all know, there are various different levels at which there will be a proportionate inspection. It is not that you are just not inspected at all, because you are right that £6.5 million or anything more than a few hundred thousand—or less—is a considerable amount of money, we propose tiered provision within that range. It’s only after £6.5 million, however, that it becomes a full audit. People in business will be aware that the same thing operates in the private sector; every company has to file accounts, which you still have to send back to Companies House, but you don’t have to call in the auditor, although you must call in an accountant, to sign those off. You’re relying to an extent on the professionalism and the professional reputation of the firm that comes in and does the work. After all, its reputation is probably always worth more than your individual—I won’t call it audit under £6.5 million—accountancy work.

Q565 David Heyes: The figure that’s being set is, I am sure, being welcomed by some of the representative bodies for the smaller organisations; the logic is accepted. I am trying to get at how much of the total pot of local government expenditure this collectively represents. Maybe you don’t have the figure in your head, but it must be available in the Department.  

rant a s: May I offer to write back with that figure? I don’t have the figure in my head, as you have rightly guessed, but I would be very happy to come back to the Committee with it. As you have said, there are a few hundred organisations in that position. Bear in mind that in private business there are probably hundreds of thousands of companies in that position, so a few hundred is not unmanageable at all, but I would be very happy to write back with some sort of indication. Again, the consultation is genuine consultation in this regard, and we are interested to hear the Committee’s opinions on whether we have got these different levels right and the level itself correct.

Q566 David Heyes: Just to be clear, what would be helpful to the Committee is, if possible, the breakdown between each of the levels 1 to 4 that appear in the consultation document. If that is too complex and too demanding a request, the total local government—local public body—expenditure represented by those four groups would be helpful for the Committee.  

rant a s: Sure. We will pull together some figures to try to satisfy exactly that.

Q567 Bob Blackman: May I clarify one issue? Is the £6.5 million level going to be increased in line with inflation each year?  

rant a s: Not each year. As I understand it, the £5 million figure came in with a piece of primary legislation, and it went up to £6.5 million under an SI. We have pitched the £6.5 million, because it’s the same figure as the private sector. The more you can unify some of these things, the easier it is to introduce more companies, and therefore competition, into the marketplace. That is why we suggest the same limit. It would be a proposal—a suggestion—to keep this in line with private industry, but I think it probably requires a statutory instrument rather than just a statement to Parliament. There may be a little bit more to it than I can commit to in giving you that assurance.

Q568 Bob Blackman: It would be helpful, if you are going to clarify the other issues, to detail how that will be set up. Moving on to another area, the Audit Commission’s work as auditors is quite well respected by people. I think you have said it is the fifth largest auditor.  

rant a s: It tells me so.

Q569 Bob Blackman: One of the concerns will be how that expertise is retained. How are you proposing to transfer that expertise into the private sector?  

rant a s: We have made no secret of the fact that we would quite like to see a mutualisation as one potential outcome from this, so it could just be retained within a body that is doing very similar work. That is one possibility. People spend years, of course, getting their audit qualifications, and they don’t give them up lightly or just cease to practise. Certainly, all the accountants and auditors I know tend to stay...
within the sphere. So my expectation would be that they would either work for the successor organisation, or perhaps for a different audit firm which is now involved in this line of work. Again, that goes back to the earlier question. It is irresponsible to go out there, in newspapers, suggesting spurious timelines that are not the ones that the Governments have agreed or are working to, which just provides uncertainty for people who work very hard. We have been very clear that we are not critical of the audit work on the ground. What we are critical of is the structure that has been built up around the Audit Commission.

Q570 Bob Blackman: One of the concerns that has been expressed, which I share, is that were this to go to a managed buy-out or some sort of organisation that immediately gets bought out by one of the big four, then immediately you have distorted the whole marketplace quite radically.

rant a s: I am not saying this to the Committee then? I am very conscious that what needs to end up coming out at the other end of all this is more competitiveness, not less—this is not some kind of QinetiQ-style stitch-up—that does not over-award those who just happen to be in the right place at the right time, but instead rewards the real workers at the Audit Commission, if the Audit Commission goes down the mutualisation route. We will investigate all those points in the draft legislation as an outcome from the consultation, but I am very clear about one or two of the things that it should not be, and you have just mentioned one of them.

Q571 Bob Blackman: So are you proposing some restrictions that would prevent one of the big four from buying any organisation that emerges?

rant a s: As I have said, the objective is very simple. We must increase, not decrease, competition in the marketplace. Because the Audit Commission is a large player in the marketplace, simply having it disappear and not having more firms come in and trade in the space would clearly be counter-productive to the approach that we seek to push.

Q572 Bob Blackman: Are you saying that the local authority marketplace will be a marketplace where the Competition Commission will have oversight, and would therefore become subject to the competition legislation?

rant a s: Perhaps we will have to wait for the outcome of the consultation and the draft before we can get into that type of detail, but what I can say is that it should be a more competitive marketplace. If it were not for the fact that it had a national quango overseeing it right now, it would probably already be subject to competition queries, because it cannot be right that there is one 70% player and another four in the private sector which make up the other 30%. This is not a balanced marketplace at the moment. I do not believe that it is working to the competitive advantage of its clients—ultimately, taxpayers and local authorities. That is one of the reasons why I am so confident that there is a large amount of money to be saved by having a more competitive marketplace.

Q573 Bob Blackman: An alternative approach to the managed buy-out might be to break it up and sell off different sections. Has that been a consideration?

rant a s: We will have a look at all the various possibilities. We are not closed-minded about the way that this ends up, other than to say that it must increase, not decrease, competition in this particular marketplace.

Q574 Bob Blackman: In terms of these options, have you formulated a preferred route for how the Audit Commission goes into the private sector? You have mentioned mutualisation as being quite attractive. Is that the preferred route?

rant a s: In fact, this is, again, beautifully transparent, because if you read the consultation document, it is only at the points where we say, “This is our lead option, tell us what you think,” where we have a preferred route. Other than that, it is a very genuine consultation, a genuine draft Bill and a genuine desire to know what the Committee has to say. So, we are not trying to push one particular outcome, but the principle of further competition has to be at its heart.

Q575 Bob Blackman: What resources would you commit to enable the managed buy-out or mutualisation to actually get up and work? One issue of concern is that the Audit Commission might be very good at auditing, but it is not very good at bidding for work, because it has not had to do it.

rant a s: Again, what resources we will commit is a premature question for this stage of the process. By the way, we might as well put on the record that we recognise that there are, of course, some costs involved in any kind of change. What we are confident about are the ongoing year-on-year savings. The addition to competitiveness will far outweigh those initial costs, but, no, we have not got to the point where we think it will cost x to come to y conclusion, which is the point of consulting on various options.

Q576 Bob Blackman: So, you are consulting on the options at the moment; you will reach a conclusion; and then there will be a draft Bill. At what point is that decision going to be made?

rant a s: A draft Bill is exactly what it says on the tin. It gives a clear indication—even clearer than a White Paper, and certainly clearer than a Green Paper or a press release—of what we think should happen in the future. If you ask what is in our mind, you will have a clear view of what we think when you see the way in which we have described it in the draft Bill. By not going into further detail, I am not being evasive to the Committee. Sometimes consultations get a bad name, so I want to row back and make sure that consultations are worth while, achieve something and are useful. Other than setting parameters and saying that there is a better way of doing this, so we are going to get rid of the one organisation that has all the responsibility for regulating, commissioning and providing, we are genuinely open-minded about the matter.
Q577 Chair: Minister, you have said today that Government have said that there is support in principle for “our mutuals”. Is there a recognition that some additional support—at least initially—might be needed to ensure that a successful mutual is created? 

rant a s: Again, you are drawing me further than I am able to go. A mutualisation, as I have discovered from studying the subject, is not one thing. There are lots of different ways to mutualise. Of course, we would have to look at that and at the other possibilities, and work out which one is most cost-effective for the taxpayer. Again, this is real bread and butter stuff for the impact assessment. We are getting to the real nitty-gritty of the upfront costs and the savings.

Q578 Mark Pawsey: May we come back to the issue of the competitive environment and the ability of local authorities to choose from a larger number of providers of private audit services? You have made it clear that you think that a more competitive environment will lead to lower costs of audit. Have you any assessment of by how much the average local authority’s audit bill might fall?

rant a s: We know, don’t we, that there is a 20% surcharge no matter what happens, which covers the corporate overheads of the Audit Commission. I don’t think that there is any good reason to have a state surcharge tax on auditing in that way, and that is before you have introduced competition into the model. It stands to reason that if you want to win the work, you need to be competitive enough to do it. Whatever the number we start off with, if the professional bodies were to say, “Yeah, they are good enough to regulate. Go out and regulate our various local authorities,” other people would enter the marketplace. We want to open this up properly to allow people to shape themselves up to specialise in this area.

Q579 Mark Pawsey: But larger bodies won’t have that much choice. There are the big four plus the new mutual. That is not an enormous amount of competition.

rant a s: I don’t think that that is necessarily right. By the way, it is not the big four that are in this market. There is the big three, not the big four, and then there is Grant Thornton, so it is not the big four. Clearly, this could go much further. Local authorities cover an enormous range. The idea that only that auditor is capable of auditing both the budget of my local authority of Welwyn Hatfield, which is between £14 million and £20 million, and the budget of my county of Hertfordshire, which will have £1 billion, must surely be complete nonsense. You could probably get much better fits if you had competitors coming into the marketplace. They could say, “What we do is specialise in audits of this type.” You will get more competition, because you are allowing people to specialise.

Q580 Mark Pawsey: We know that when a new market emerges, which is what will be happening here, private contractors pitch in at very cheap prices. What are you doing to prevent local authorities from being made hostage by accepting a very cheap price for years one and two, but having to pay a great deal more later. If the savings exist, how will you ensure that they are savings in perpetuity?

rant a s: Those of us who have started up businesses or been in private business know that when you get fed up with your auditor playing that old trick of enticing you in with a low price and then putting up the prices you get rid of them. You just get rid of them. You don’t put up with it. Our big argument with the existing set-up is that you just have nowhere else to go. If the Audit Commission says that it’s okay, you can have a private auditor come and do it, as long as you pay the Audit Commission 20%. It is that lack of competition.

By the way, I don’t want to be unnecessarily critical of the Audit Commission, which has done a lot of good work over the years, particularly on the ground, but in answer to the earlier point—I should have mentioned this earlier—one reason why it is difficult to work out precisely what the savings are from the Audit Commission’s own accounts is that they are the least transparent accounts that I’ve ever read. It is almost impossible to see what’s going on in them, so they are not a good example.

Q581 George Hollingbery: Minister, is there not going to be a natural tendency, acknowledged in paragraph 3.7 of the consultation, to coalesce, and to have regional groupings of authorities that allow audit firms to bid for their work? Clearly, smaller councils will be picked off if they’re not careful, or not find auditors at all. Large ones will find it easier. I can imagine a real impetus for councils coming together to have pitched at them inducing rates. In the end, is that not likely to favour bigger providers rather than smaller ones? That is the first point. Secondly, is there not also an issue about capacity because of the coterminal year-end of all councils?

rant a s: On the first point, it’s possible to construct almost any “Won’t this happen, won’t that happen?” end scenario, but we know what happens in the private sector. That’s a well-worn road, and we can see how auditing is done in a vast number of companies, many of which are at least as big as or much bigger than many of our local authorities, particularly at district level. You’d think this is a model that has never been tried or tested anywhere in any circumstances, but the opposite is the truth. To auditors this is just bread-and-butter work, and they do it all the time.

In terms of coming together to buy services, yes that’s possible and to be welcomed, but local authorities will be conscious of wanting flexibility. If the whole of Buckinghamshire, for example, gets together and decides to have the same auditor, that is fine, but it starts to limit their ability to dismiss an auditor and get someone else if they don’t like the pricing structure and so on. They probably won’t want large, nationwide deals, but it is up to them. One assumes that the market will take over, and if it becomes too large an area, someone else will go to that area and say, “Hold on, we can do a better deal for you”. The market will sort it out. We don’t have to second-guess it for them—
Q582 George Hollingbery: In that commercial companies have their own year-ends throughout the country?
\textit{rant a s:} In totality, the capacity already exists in the auditing world if we include the country’s fifth largest auditor. I said that I don’t expect the auditors, who are experts in their field, and the Audit Commission to disappear. Many of them will continue to work in the Audit Commission or in other private business, so we’re not losing resources. What we’re doing is getting rid of what has become an unwieldy and overblown Commission that had started to lose its way with its various overheads and priorities.

Q583 Chair: So your expectation is that the audit fees of councils on average will fall by around the 20% that is the Audit Commission’s current surcharge, and then probably an extra amount due to increased competition. Is that the expectation?
\textit{rant a s:} No. Bear in mind that the regulator sets a price at the moment, so we don’t know what the market price is doing, because it is setting the price of audit, and then charging 20% on top of whatever it is.

Q584 Chair: You’d expect the savings to be at least 20%.
\textit{rant a s:} I am steering clear of saying I think the correct price is the current price less 20%, and that that’s the market price. That probably isn’t market price because the regulator is setting the price at the moment. But we know that it must be attractive enough to draw four other firms in at the moment, and at the current price. We can see from that that it must be high enough, as things stand, to be attractive to private business. In any rational conversation about it, you realise that if it’s high enough to attract them in at the moment, plus 20% for what the Audit Commission creams off the top, then a market price is probably rather more competitive.

Q585 George Hollingbery: Are you sure it’s not a loss leader?
\textit{rant a s:} I don’t think so, unless someone can correct me. I don’t think that, just because you are Grant Thornton and you work at the Audit Commission’s commission on a council’s audit, you can somehow get money from some other place in Government for it. No, I don’t think it can.

Q586 Chair: So you might argue that the more work that goes out there, the more the price would go up?
\textit{rant a s:} It would be counterintuitive if it did; it would be completely against what happens when you introduce more competition to virtually any market. What I am arguing is that the fact that there are private companies that are already prepared to go and do the work on the basis of current payment suggests to me that with a more competitive marketplace, prices would fall—and that’s before you add the Audit Commission’s 20% on to that.

Q587 Simon Danczuk: Just a quick one. On the 20%, is it not what the Audit Commission indemnified? It’s sort of an insurance that it provided for the auditors.
\textit{rant a s:} That’s one element of it, but the rest of it runs its corporate back office services and pays for things such as drinks and receptions for five grand at—sorry, I didn’t mean to cheapen it by mentioning its Royal Horseguard Hotel’s reception.

Chair: That’s a lot to drink, to get to £50 million.
\textit{rant a s:} Not when you consider that at this particular knees-up, only 34 people attended—for five grand of expenditure.

What I am saying is that that 20% doesn’t just pay for indemnity, but for corporate costs. There have been very few claims, by the way, of indemnity, so if it were for just indemnity, it would be building up quite a nice little pot.

Q588 James Morris: Turning now to the inspection of performance management function that the Audit Commission had, one of the arguments in favour of the performance management regime that it implemented was that the quality of local government rose. At the time when the Audit Commission was established and throughout the whole period, there was a need to raise performance across the country. We’ve now got to a stage where the sector has achieved a level of maturity that people such as the Local Government Group argue that the sector is capable of assessing itself, in a kind of peer review model. Now, that’s fine as far as it goes, but what happens where we have a serious issue of service failure? Does that not worry you?
\textit{rant a s:} First, I want to agree with your assessment. I think it is true that quality has gone up. I pay due regard to the Audit Commission for helping in that process—perhaps not in its recent years, but earlier on; that is all true before it got all bureaucratic. We are living in a very different time; it is much more transparent. When the Audit Commission was set up, the internet didn’t exist and people couldn’t find out what was going on in their local area, and the transparency and localism agendas of this coalition Government weren’t in place, so we were in a very different place.

You asked about who sounds the alarm when something is going wrong under the new system. The answer is that there are still many different protections in place. Transparency is a new one; in addition, people can really see what is going on locally. Secondly, the auditors would still have a role. We have investigated the extent to which they and audit committees could sound the alarm. In fact, the Secretary of State can still have concerns and have a team sent in to investigate, so there is no lessening of that.

I want to stress that even under the extraordinary number of investigations that took place—comprehensive area assessments and the rest of it—Doncaster still wasn’t spotted particularly early in the process, so it is not that the current system has an incredible track record of sounding the alarm very
early. Peer inspection and peer review have an important part to play in all of this as well. There are multiple different mechanisms to sound the alarm when something is going wrong.

**Q589 James Morris:** Do you think that there may be some issues? It is quite a significant cultural shift for local government, going from the culture of top-down inspection to a peer review model. Do you think that there is a danger in the process of that shift? Performance may plateau or go down among certain local authorities that are not the high-performing ones at the moment.

**rant a s:** I think you could argue that, but you can equally vociferously argue exactly the opposite, which is that, given a little time and independence, and if you stop sending the inspectors in to tell people exactly what to do and where, when and how to do it, quality can go up. It is notable in my area of housing, that when Portsmouth employed a housing person who started to the ignore the advice of the Audit Commission, which thought that it was more important to tick boxes to get two stars than it was actually to respond to the desires, will and real concerns of the tenants in the housing stock, the real quality of service provision started to improve. I am just so certain that if we can get beyond a tick-box mentality and beyond sending in the auditors to tell people whether they’ve got one or two gold stars, and if we can get to a situation where people are really focused on what their customers—their tenants, their service users, their residents—want, we can drive standards up, just as much as down. Of course, peer review is nothing new; it’s been going on for quite some time. Across the House, people believe it’s been very good, and those in this room who’ve been councillors will know that it’s a good and worthwhile process and every bit as useful as formal auditing.

**Q590 Heidi Alexander:** I want to pursue this line of questioning a little. We could liken the peer review process, as proposed by the Local Government Group, to telling a class of undergraduates, “We’ll get other people in your class to mark your essays.” A lot of people might look at that and say, “We’re not actually sure that that process will give us a comprehensive, professionally done inspection of the work that’s going on.” How confident are you about the Local Government Group’s ability to carry out this function robustly?

**rant a s:** If that were the only mechanism in place—let’s say that at some extraordinary extreme, the proposal was to have no audit at all and that we would just have peer group review—that would certainly be completely mad, and it would become a problem. But that’s not what we’re suggesting; we’re still suggesting full audits. Anyone who’s been through an audit in the private or public sector will know that they can be pretty intensive, quite harrowing processes, which genuinely make you look back at your processes and so on and so forth. The peer review groups will be able to reflect on what auditors have said and will, I guess, have that sixth sense you have because you kind of understand things when you do them yourself. I think peer reviews have several benefits on their side.

**Q591 Heidi Alexander:** Admittedly, the audits will be available, for exactly the purposes you’ve talked about. You referred to Doncaster and the perhaps malign influences that might exist at the top of an organisation where relationships aren’t working properly. Who would you see making the judgments and interventions in future? How and when would they do that?

**rant a s:** I’m just trying to get to the bit of the council you mean. Do you mean the officer at the top of the organisation is in conflict with somebody else?

**Q592 Heidi Alexander:** It could mean a whole variety of things. It could mean relationships between senior officers and the politicians weren’t functioning in a healthy, creative way. You’re saying that the last mechanism didn’t adequately address the Doncaster issue. How do you see the new one working?

**rant a s:** First, as to what’s great about peer review, the very first question you ask somebody—we all have these conversations as Members of Parliament—is, “What’s your relationship, as the politician, vis- -vis the chief exec of your council?” That’s a conversation I can easily imagine having with colleagues in this room, and each of our relationships will be somewhat different. Someone might say, “That’s interesting. I find if you do this, they do that.” Peer review will actually be quite a valuable way of looking at potentially reassessing those relationships or raising a flag and saying, “Hold on, there’s something going horribly wrong here, because the political leadership and the officials are running in exactly the opposite direction, and that’s causing a problem.”

In the case of a Doncaster-type situation, you’ve got the audit, the peer review and the councillors, and the Secretary of State is able to send somebody in. There are many contributory factors to Doncaster, but anyone who knew anything about it knew that everybody knew there was something wrong. It’s just that everyone assumed that the Audit Commission was the body that had to do something about it. Again, there is a bit of an empowerment question about who can raise the alarm. One of the outcomes of doing away with the Audit Commission will be that there is a responsibility on other people’s shoulders. People will not feel that it must be somebody else’s job to raise the alarm when they have done a peer review and there is something horribly wrong. They will know that a quick letter to the auditor, the Secretary of State or whoever is required, is in order. It is a bit like taking personal responsibility—social responsibility—for it. All of that will help a lot as well.

**Q593 Heidi Alexander:** Under what circumstances will the Secretary of State decide to send someone in?

**rant a s:** The powers are very similar at the moment. We are not proposing great changes on this. Again, it is a case of removing a bit of the bureaucracy, so that you can get on with these things. I don’t know about others here, but I was certainly
aware—Doncaster is a case in point—that there were problems in Doncaster. I suspect that everyone knew of it, but somehow a formal inspection didn’t take place, even though I think I am right in saying—apologies to the Committee if I have got this wrong—that a CAA inspection didn’t get to the point of pulling in a proper formal investigation until within a year of the formal investigation. So something wasn’t working there. What is put in place, including the peer review, should provide people with the necessary muscle and confidence to raise the alarm much sooner.

Q594 Simon Danczuk: You mentioned the comprehensive area assessment. One of the good things about CAA is that it encouraged local public services to come together and work together better. My concern is that now that that has been taken away, that won’t occur. I did some quick calculations. I estimate that it is going to cost taxpayers about £100 million each year in the loss of joint working. I am not prepared to publish the calculations, obviously—after Post-CAA, what is going to drive effective partnership working?

rant a s: First, I should say that I respect your decision not to publish the £100 million calculations. But, a few months down the line, I expect you to publish a very detailed analysis indeed, giving us chapter and verse on that. I don’t recognise the CAA as you do. The CAA was largely a complete and utter waste of time. My Department paid £28 million for it in the one year that it took place. I don’t think that was value for money. I can speak from local experience of the CAA and tell you that, as far as my local council was concerned, it ate up a load of its time. If you added that up throughout the country, you’d have well over another £28 million wasted in terms of officers’ and officials’ time spent answering questions on the CAA. I have to tell you that the outcome did not make one jot of difference on the ground in our area. Let us bear in mind that those involved with the CAA went around analysing, speaking to people and repeating things. Unlike the comprehensive performance assessments before it, that was not generally primary work, apart from going in and annoying the officers in your town hall. The rest of it involved looking up old data for all that money. I just don’t recognise your plucked-out-of-the-air figures and, unless you can give me an impact assessment, I shall be querying them for ever and a day.

Getting back to the 2006 report that showed that officers spend 80% of their time looking the wrong way and to Ministers like me, and therefore only 20% of them work for their residents, that is an absolute disgrace. How can we expect local democracy to work and more than a third of people to go out and vote if people think that it doesn’t matter for whom they vote because the local council always wins? We have to create a situation in which democratic values are at the heart of the matter. That means that rather than being answerable to me as the Minister, officials need to be answerable to their members and, through them, to members of the public. That’s the big, big change we need to see.

Q595 George Hollingbery: I have to ask this, Minister, with a slight grimace, on the basis that I’m not sure that I necessarily believe that the Audit Commission allowed comparison between authorities, but do you think it did? If you don’t, how do you envisage the marketplace, the £500 transparency and the armchair auditors working in a sufficiently consistent way to allow people to make comparisons between authorities?

I shall interject briefly to give an example. I have bored the Committee with it before, but planning costs in one area can vary enormously with planning costs in another simply because they are different places—one has lots of historic buildings and one doesn’t—and you need very different sorts of staff. How do you make that comparison in value?

rant a s: At the moment, we’re supposed to understand whether we’ve got value for money only because one public body has come and inspected and told us. Some fledgling services, such as UpMyStreet, mySociety and others that work for us, are getting in and starting to expose things. We believe that all the signs are—because it’s happened in every other area of public and private life—that if you provide the right climate, with transparency, data openness and data that are available not as PDF spreadsheets, then people will step into that breach. We’re starting to see the TaxPayers’ Alliance, for example, becoming much more active in making some of these comparisons; and lobby groups such as Age UK will take data. Shelter, one of the organisations that falls within my housing rather than the local government remit, recently published a fantastic website that compared the affordable housing required within any given area—required by independent inspection—saying, “Here’s a league table of authorities and how they’ve done.” The chief executive of Shelter told me that it came in for an awful lot of stick, and I said, “Great. We’ve got to go it again.” The truth is that this was much more meaningful. There was a proper news story, whereas the publishing of a comprehensive area assessment went down in my area almost entirely unnoticed. You can do a lot more in the 21st century with open data, transparency, and with lots of social organisations such as FixMyStreet comparing data rather than thinking that the only way to do this is to have the Government come in and do it for you.

Q596 George Hollingbery: You and I both come from a private business background. I suspect that you have discovered, as I have, that the Government do not operate in the same way. Yes, of course there are value for money issues, and of course there is a price for pencils and plastic cups, but what is the price of a particular social policy decision—something that has to be done in a certain way? How do you put a value on that for accounts? How do you drill down into the accounts to find out the social policy intention of a council, and value one against another?

rant a s: I agree that that is a huge question, which we grapple with in Government all the time. When we propose a policy such as neighbourhood budgets or something like that, we try to work out how much it would save in the longer run, but those
calculations are never as easy as you think they should be. The idea that anyone has ever been asked to open up a comprehensive area assessment and solve the problem is, I’m afraid, so far from the truth that it is meaningless.

Q597 George Hollingbery: With respect, we haven’t got them any more. They’ve gone. Why did yours work better?

rant a s: It is a bit like my practical example with Shelter picking up on one piece of data; it was understood to be a specialist in housing, and was able to compare data and make significant changes. After it published that, we were seeing a real change in town halls, in some of their planning assumptions or policies, towards affordable housing provision, because they didn’t want that story next year in the same newspaper.

Specialists who understand the subject are able to provide a much clearer steer for the public, and through public opinion you’re able to make much greater shifts. The public are very savvy about these things. I mentioned before that turnout in elections is so small because people aren’t stupid; they know that these decisions have all been taken out of their hands. When you return democracy to a local level, it’s quite likely that over a period of time—a generational shift will be required rather than what happens in May alone—people will go back to the ballot box when they understand that the decisions they make there have an impact on local services.

If I want to see better housing provision in my area, then I know that I have to vote in a particular way because I’ve heard that candidate talk about it. Unlike at the moment, that candidate has some influence on the outcome, because of a range of policies such as the New Homes Bonus and so on. But it is much more than that. It’s a different mindset.

I understand why people struggle so hard to grapple with the idea that judging, for example, how good a service is will not in the future simply be a matter of asking one auditor to make a single judgment. As I described in respect of Portsmouth, as it so happened the judgment was complete and utter nonsense. It was not helping the tenants in terms of housing; it was just satisfying a tick-box exercise that was not worth the paper on which it was written.

We will reach a much better position. I am not taking an absolutist view. I have already said that the value for money work still continues within audit. We will not throw the baby out with the bathwater. It is incredibly important to make sure that people have good authoritative sources on which to base their judgments, but we need to get into a world in which people can reach judgments and not just be told what they think.

Q598 Chair: The public interest reporting will remain. When we met the professional bodies and the Financial Reporting Council at our previous sitting, they raised concerns about whether a serious conversation between the auditor and the auditor body was likely to occur, particularly when the auditor body will be asked to pay for the privilege of having a public interest report done. Will that arrangement really work?

rant a s: I have heard that argument lots of times. It is not incredibly dissimilar to what happens to a private company when an auditor is hired, and whether auditor has to be paid is queried and the answer is yes. For that matter, it is not dissimilar from the Audit Commission acting as the regulator, commissioner and provider at the moment and saying that it has to be done and the audit has to be paid for.

Q599 Chair: But the Audit Commission fixes the cost.

rant a s: No. Let us take, for example, the Doncaster situation right now. Doncaster is paying for the work that is being done by the Audit Commission having to go in and do the additional work. It is charged back at the moment and it will be in the future.

Q600 Chair: Let me go to the issue that Bob Blackman raised, which relates to my first question about the fact that the Government clearly decided that the Audit Commission’s roles for commissioning will go. It will not be the provider of audit services, but there are regulatory functions. Your consultation very much mirrors what happens in the private sector for auditors, with some of the same bodies doing things. The other day, the House of Lords Economic Affairs Committee carried out a report on market concentration, which looked at audit. It was pretty condemnatory of the regulation of accounting and auditing, which, it said, was “fragmented and unwieldy, with manifold overlapping organisations and functions.”

We will change what is a perfectly simple system with the Audit Commission doing everything into the same system under the private sector. Would it not be better to take all those regulatory functions and put them in one body—whether it is the National Audit Office or another body?

rant a s: I disagree with that. Effectively, the current set-up has everything that we will have in the future, plus the Audit Commission on top of it. In fact, we are simplifying matters rather than making them more complicated. As I hinted earlier, the Audit Commission overlaps with professional bodies, which also look at whether, for example, audit companies are fit to do the work. You have duplication. If an audit firm wants to do an audit right now, not only does it have to satisfy professional bodies, but it separately has to satisfy the Audit Commission. Removing the Audit Commission, therefore, is a simplification, not a complication, of the structure.

Q601 Chair: Well, you satisfy the professional bodies in terms of being an organisation that is capable of doing it, but not in terms of actually being an organisation capable of doing local authority audits per se. That is the Audit Commission’s role. That is a role that will get transferred back into one of the regulatory bodies, which is currently not with them.

rant a s: My point is that you end up wanting to do an audit and you have to be signed off by more people than when the new process comes into place.
If anything, this is a stripping away of a layer of bureaucracy, not a complication.

**Q602 Chair:** So in terms of the consultation, your mind is made up about the split in regulatory functions among a number of bodies.

**rant a s:** My view, of course, is exactly as in the consultation, but I challenge the idea of not having an Audit Commission with everything vested in one place. At its extreme, you could apply that argument to almost any industry and say, “Wouldn’t it be easier if we didn’t have competition in every area of life?” I guess that is why communism looks so attractive: the state could organise everything and tell us how many tractors to produce and so on. We know that the reality is that a free market, which probably—if you drew a diagram on paper—would look a lot more complicated, turns out to be a lot more efficient. There’s a good summation of the reforms that we are putting in place with local audit. The bodies will be just much more efficient.

**Q603 Chair:** But you did indicate that the National Audit Office might have a role to look at any systemic failure that might occur.

**rant a s:** Yes. The National Audit Office has a role with the code of practice as well; it is answerable to Parliament on the code of practice and any systemic failure—that is right. Just in terms of getting through to producing an audit, if I am a firm that wants to compete in this market, I need to be fit to be able to carry out these kinds of audits. I now have to satisfy the professional body, but I don’t have to satisfy it and then go off and get qualified by the Audit Commission, which I gather qualifies very few people to do the work.

**Q604 Chair:** Finally, the Comptroller and Auditor General, when he was here, said that these matters were not simply a question of identifying savings improvements, but of making sure that they were implemented. Are we going to see the Government put in place a rigorous system for measuring whether, over a period of time, the improvements and cost savings that you have referred to today actually come about?

**rant a s:** Yes. What we are going to do is to remove capping and invite local people to carry out a referendum if the local authority is so inefficient that it has to put up its council tax by more than whatever percentage.

**Q605 Chair:** I am still thinking about the audit arrangements, not just local government generally.

**rant a s:** My answer to your question is that we are transferring the responsibility to the public, who will be able to decide through referendums and through elections whether they have an authority that has done the right things. If it has, it will be efficient and able to provide the services that are required locally, and have a council tax that is reasonable; if not, local people will presumably boot it out of office.

**Q606 Chair:** What about whether the Government have done the right thing—whether your savings from abolishing the Audit Commission come about; whether the cost of auditing fees goes down; and whether there are improved audit arrangements? Are you going to put in place steps to make sure that those matters are measured and that Parliament can have information about whether you have achieved the success that you believe you are going to achieve?

**rant a s:** Of course, starting from where we are and up front, the impact assessment will go into incredible detail about the savings that we think can be made. The code of practice will be debated in Parliament. Parliament will be perfectly at liberty to check, and to call in Ministers to see whether the system has done what it is supposed to do. Parliament—and Select Committees, for that matter—will no doubt take a very close interest in it. There will be lots of different ways to test whether all this stuff down on paper actually comes out with the savings. I have to say that logic on every single level tells you that it literally has to, because you remove a very big, expensive regulatory body, operating in a centrally driven way, and replace it with a bit of market competition, which—through our discussion of the 20% extras and what have you—we have at least established could make a very considerable saving overall.

**Chair:** That still remains to be seen, but we will leave it there. Thank you very much for your time, Minister.
Written evidence

Written evidence submitted by David Walker

— The decision to abolish the Commission was a classic example of government by ministerial whim.
— But abolition could still present an opportunity for ground-clearing discussion about audit and accountability in local spending, and reconstruction.
— The weight of central government grants means MPs cannot alienate to councils responsibility for auditing the spending they approve.
— Armchair auditing is, at best, complementary to professional analysis of financial statements but has a part to play in the rebuilding of accountability.
— “Choice” of audit by councils won’t work, because they do not raise the money they spend.
— Audit should be re-professionalised by going back to (less costly) basics.
— Value for money should be secured by local residents in a new culture of stewardship and accountability.
— CLG must model the impact on local government of inspection regimes maintained or supported by the health and education departments.
— A New Audit Organisation, responsible for a unified audit regime for public bodies in England, should take responsibility for appointing local authority auditors.
— Auditors may come from private firms, but subject to strict tests of quality and competitiveness, especially among the Big Four.

1. INTRODUCTION

The decision to abolish the Audit Commission was a classic example of government by ministerial whim. Ironically, a couple of weeks before the abolition announcement the Institute for Government had called on new ministers to examine the landscape of their arms length bodies, but urged them to pay close attention to why this or that function was being carried out by a specialist or dedicated organisation. (1)

Abolition was preceded by no consultation external to Whitehall, not even with local authorities or the accountancy profession. (Ministers may have talked to consultants; KPMG recommended “dismantling much of the current Whitehall policy, funding and regulation functions in departments, agencies and NDPBS) and actively de-regulating eg local government performance assessment, etc. (2) Yet inside Whitehall, it seems only perfunctory efforts were made to talk the plan through even with HM Treasury and Business, Innovation and Skills, running their own agenda for audit, regulation and the future of the accountancy profession.

As for MPs, cursory conversations between the Communities Secretary, the chair of the Public Accounts Committee and the Comptroller and Auditor General hardly count as consultation, yet parliamentarians not only “own” the National Audit Office, they may well have views about how the public money they vote should be accounted for.

All that said, the abolition of the Audit Commission might have prompted—and could still provide—a ground-clearing discussion about audit and accountability in local spending. The manner rather than the fact of the Audit Commission’s demise is deplorable. No agency or arm’s-length body should have a permanent lien on life. The Audit Commission’s accountability has long worried MPs, (3) not assured its unwieldy group of “commissioners” were effective. (Had they been they would have ordered the thoroughgoing reappraisal of the Commission that was long overdue.)

However, even after the abolition announcement, the government has promoted no wider conversation. It has resisted efforts to include inspection and, so far, failed to involve parliament in considering the future of the National Audit Office, despite making heroic assumptions about the NAO’s potential role. The Communities Secretary has repeated his faith in “armchair auditors”, but proffered no further thoughts about the practicalities of advancing public inspection of council spending nor where the boundary between public and professional inspection of spending should lie.

So this inquiry by the Commons Communities and Local Government Committee is doubly welcome. It is the first public occasion to appraise the abolition decision (announced when parliament was not sitting, by means of a newspaper interview with the Communities Secretary). Looking forward, this inquiry might supply the wider and deeper thinking absent from the government’s public utterances about the Audit Commission.

2. ABOLITION ACCIDENTALLY PROVIDES AN OPPORTUNITY FOR DEBATE AND RE-BUILDING

The government made its announcement in August 2010. Five months later, it has still to elucidate its thinking, beyond crude paragraphs in press releases and knockabout politicking, which, even for the Communities Secretary, cannot constitute policy making. Figures for savings from abolition were plucked from the air, or the imaginations of special advisers. The back-of-the-envelope nature of the decision is shown by the fact CLG civil servants did no preparatory work on the timing or content of the legislation needed to abolish the Commission. Perhaps that is why they have been dilatory in producing a bill. If local authorities are indeed
to choose their auditors for the financial year beginning in April 2012—as promised by the Communities Secretary—the amount of time now left to organise a market, competition and audit regime is disturbingly short.

The Communities Secretary said abolition confirmed the government’s wish to “scale back centrally imposed, bureaucratic and costly inspection and auditing”. But the difficulty of translating that rhetoric into practice helps explain his tardiness in bringing forward any detail.

One reason is that a spending isn’t. Seven out of ten pounds spend by councils in England come from central government in grants and apportioned national non-domestic rates income. Parliament is not going to relinquish accountability for such a large fraction of local spending. MPs are not likely to alienate to councils the responsibility for auditing money they approve, so the “centrally imposed auditing” disliked by the Communities Secretary will remain.

A crux is the amount of local spending raised locally. Locally organised audit (councils’ choosing their auditors) becomes more justifiable when and if residents pay for a much higher proportion of local spending. That may be the government’s wish—the Communities Secretary is conducting a personal review of council finance this spring. But until a major shift takes place in the balance of funding, who offers taxpayers the necessary guarantee that local authorities are spending (central government’s money) lawfully and efficiently? The answer has to be auditors over whom central government has purview.

If “armchair auditing” is a complement not a substitute for professional audit (see below), we have to ask whether abolition has, inadvertently, created space for much-needed rationalisation of public audit, perhaps pointing to a single regime or organisation with an England-wide span. The same regime might assure the residents of Bolton as those of Bournemouth that spending in those two places is economical, efficient and effective, while at the same time satisfying their representatives in parliament, who vote the money those authorities spend.

3. This is no Technical Debate; Large Issues of Principle are at Stake

“Localists” say that if councils possess political authority, derived from their democratic legitimacy, why should they not choose their auditors. If they are deemed capable of taxing and commissioning services, why not also procure audit? If company directors and charity trustees can manage it, why not councillors?

Historically, district audit was a tool of political as well as financial control. Complaints about it were more audible from the left of politics than the right because audit was a way the central government corralled and constrained ambitious local action. In the 1920s district audit was “disastrous interference by an appointed bureaucrat in the free and spontaneous discretion of elected councils to carry out their work in their own way responsible only to public opinion and their own constituents”. But the difficulty of translating that rhetoric into practice helps explain his tardiness in bringing forward any detail. But “choice of audit” as a slogan is problematic, and not just because so much local spending is in fact national in origin. Audit itself is in flux. The Financial Services Authority is exploring ways of breaking too sweet a relationship between private companies and their auditors. The European Commission wants external (“independent?”) appointment of company auditors. The House of Lords Economic Affairs Committee is worried about concentration in the audit market and asking why auditors—often from the Big Four firms—failed to check the excess of lending and spending that led to the financial crash. Debate continues on the role of non-executive directors in organisations both for- and non-profit, and their responsibility for independent assessment, including the appointment of auditors.

How peculiar needs public sector audit to be? Why can’t auditors of public bodies use the methods applied to profit-making entities? Why shouldn’t a “true and fair” opinion on financial statements (the formula for private companies) be sufficient for public bodies—provided their political and financial accountability is otherwise secured? The answer to these questions has been: public bodies are insufficiently accountable and auditors need to fill the deficit. But isn’t it time to attend to the gaps in political and financial accountability where they exist, and let audit shrink back into its professional riverbed? Do we really need separate a dit, as opposed to a nta i it , regimes?

Is the pursuit of value for money principally a technocratic or a political exercise? Surely the latter: councillors, the public and council officials all can determine value for money; the question is whether they are trusted to do so. The government says it trusts the public. It wants to empower the public to ask sharper questions about value for money by requiring councils from January 2011 to publish transactions data above a £500 threshold. (Its Labour predecessor was on the same track.) But how much subsequent exploration is needed to make sense of such data, and establish “accountability”; how far is such exploration a matter for professional auditors?

Part of the answer lies in the history of the Audit Commission. After its establishment in 1983 it moved smartly into assessing the performance of councils. Recent critics of the Audit Commission’s performance regimes forget the welcome given its muscular extension of probity auditing into the much more complicated and “political” arena of value for money by the Thatcher government in the 1980s. But did it succeed in winning more value for money? The Audit Commission could uncover examples of inadequate value and pose a question but had no responsibility for any answer, let alone any follow up. That impotence, and the lack of an alternative mechanism to secure value for money, pushed the transformation of the Commission into an assessor of performance. From “best value” through Comprehensive Performance Assessment then, last,
Comprehensive Area Assessment, the task became judging a council’s delivery—in the hope disclosure would prompt local remedial action by councillors.

Two flaws were quickly apparent. What competence did auditors possess in evaluating service delivery, let alone “governance” in a local authority; were they being pushed beyond their sphere? Reading a balance sheet does not necessarily imply understanding of management structure or the relationship between political intention expressed by elected members and service outcomes, which themselves depend on demography, income, economic opportunity as well as organizational capacity.

The limits of the Audit Commission value for money model became apparent in the launch of Comprehensive Area Assessment. By ascription rather than design, the Audit Commission had acquired the function of setting standards for public service delivery—of grading councils according to its or the government’s criteria of performance—and no wonder this grated with elected representatives from all parties. It denigrated politics and democratic representation. Resentment at this usurpation of elected members’ political birthright fuelled criticism of the Commission from local government.

4. AUDIT RETREATS; ACCOUNTABILITY GROWS; INSPECTION IS ANOTHER MATTER

The work of the Audit Commission in recent years was repugnant to localists.(7) League tables could never recognise the diversity of circumstance in local areas. Performance management implied councils were in tutelage to bureaucrats or ministers. But the distinctions between audit and performance management and inspection are big. The abolition of the Audit Commission is a moment when audit can finally be sundered from the other two. Performance management has to be localized, but not audit. As for inspection, the boundary between it and audit has never been clearly mapped and CAA exposed how ill defined it was, in schools, policing and social care. In those areas, powerful ministers and interest groups, including sections of the public, willed the maintenance of separate, external service inspection regimes.

In recent years, Communities and Local Government and its predecessor departments have been among Whitehall’s weaker brethren. Its capacity to influence education, health, the Treasury and other departments has been limited even when, in its guise as the Office of the Deputy Prime Minister, its political head occupied a front rank position. The present Communities Secretary appears as marginalized as his predecessors, when it comes to decisions about schools or GP practices or—from the Treasury and BIS—about audit.

Neither when the abolition announcement was made nor since has the government shown much inclination to look at inspection and regulation in the round—even to build upon the reviews undertaken by the Labour government. The perceived “burden” of CAA had a lot to do with the inspection regimes operated by Ofsted (answering to the Department for Education) and social care regulators answering to the Department for Health. The perennial lack of “joined-up” government has been displayed by the exclusion of local authorities and their audit arrangements from major policy statements on school funding and GP commissioning. The disappearance of “total place” as a practical policy agenda has left the spending departments to pursue their own agendas ad hoc. The exclusion of “inspection” from the government’s thinking about the future of local spending may be a banal reflection of the Whitehall power play.

A similar point can be made about the “burden” of data collection on local government. In its criticism of the Audit Commission the LGA drew on work by Leicestershire and others, in which inspection was lumped together with central government requirements on councils to provide data, demographic, economic, health-related and so on. The present government, like its predecessor, wishes data to be more freely available, allowing the public to make all sorts of new connections online; it has even expanded some obligations on councils to provide the public with data. The abolition of the Audit Commission might have been a moment for a wider consideration of the “knowledge economy” of local public services; what data exist, what more the public need to know and, most important, how data is validated and its quality reviewed. But so far, the “cognitive” dimensions of audit and inspection have gone without debate. The Audit Commission itself was facing up to limits on its own competence—whether auditors are equipped to assess let alone validate flows of data, including even financial data, outside the principal ledgers. Now the question of the reliability of data hangs in the air.

5. TOWARDS A SINGLE AUDIT REGIME FOR ENGLAND

Is the way forward a simplification and “cleansing” of audit—leaving regulation, inspection and accountability to be addressed separately? A “hollowing out” of the audit function could save money while permitting another long overdue change—the rationalisation of what the state does to audit itself.

My proposition is threefold:

1. Local authority external audit is pared back as, properly, councils take more direct responsibility for their own performance and probity, answering directly to the local public for services and substantive financial decisions.

2. Councils remain subject to a unified audit regime, necessary because so much of the public money they spend is centrally raised and distributed. Under this regime, audit might be provided by a variety of contractors, but under a single procurement contract.

3. A single public sector audit regime is regenerated out of the National Audit Office. That body widens
its scope and the Comptroller Auditor General takes on a broader public personality as the custodian of probity in public spending at large—possibly answerable through new arrangements in which local government has a formal role, which the Communities and Local Government Committee might help convene. In the rest of this submission I call this the New Audit Organisation to reflect the fact the NAO would have to make marked changes its culture and ambit—as would the House of Commons Public Accounts Committee and Public Accounts Commission.

The idea of audit unification is hardly new. Throughout Lord Sharman’s review of audit, the prospect of unification hovered, never quite spoken out loud but clearly to be induced from his report (unification was in fact the recommendation in unpublished Audit Commission evidence). How could it make sense, Sharman asked implicitly, for the Audit Commission to seek to assess the flow of grants from the centre, which often determined how efficiently and effectively councils worked; or for the NAO to recuse itself from examining what happens to public money once it enters a council balance sheet.

A single audit regime applies in Scotland, Wales and Northern Ireland. Scotland also offers the example of a fundamental look at the relationship between audit and inspection bodies, which might have been copied in England. Though we lack a comparative appraisal, these jurisdictions offer a more transparent perhaps also a more cost effective audit set up. It is typical of Westminster governance that the experience of the devolved administrations was not tapped before the abolition of the Audit Commission was decided upon. A common objection is that England is “too big” to sustain a single audit regime, as if audit could not be organised regionally or audit provision outsourced.

The benefits of a single audit regime include uniformity, reducing the cost of training and professional preparation and also permitting England wide procurement, which in turn could reduce costs and also expand diversity of provision. The CLG Committee may discuss the role of private firms in public audit, noting the widespread concern at concentration in the audit market. The proposal here could be adapted to permit 100 per cent supply from the private sector or to retain a public sector core, for purposes of comparison and regulation—these auditors would need to be employed directly by the New Audit Organisation.

Anomalies remain. Schools and colleges are not subject to audit on the same basis as most other bodies in receipt of public funds. Audit of GP consortia has still to be determined. What might be signaled for these, as for local authorities, is a new code of audit practice overseen by the New Audit Organisation. Auditors would report to such a regime—which would take care of the problems of reporting identified by the ACCA and of course the New Audit Organisation would, using modern media, make renewed efforts to publicise auditors’ work.

6. A NOTE ON PROFESSIONAL STANDARDS

Accountants enjoy a high degree of self-regulation and the government relies on the professional accountancy bodies to carry out public functions—despite the anomalous and costly competition between the plethora of such bodies. That should not make them immune from scrutiny. One question the Committee might ask is whether the Financial Reporting Council, with its predominantly private sector orientation, is in any way placed to adjudicate some of the tricky issues posed by the abolition of the Audit Commission and creation of a new regime. Similarly, the Committee will not confuse the self-interest of such organisations as Cipfa with the public interest.

7. THE WAY FORWARD: SOME PRINCIPLES TO UNDERPIN THE COMMITTEE’S CRITIQUE OF GOVERNMENT PROPOSALS

They should reduce the impact and cost the burden of audit

But the way forward is not to deprofessionalise but re professionalise audit, particularly by reexamining the capacity of auditors to determine value for money in public services and sharply separating the audit from the inspectorial function. A stripped down audit focusing on fair accounting could be the way forward—provided there is agreement on the accountability of local political actors. The rise of localism as a doctrine surely provides a window for re-enfranchising councillors as legitimate raisers of tax and spenders of public money, without the need for a nannying auditor to second-guess their every move.

Inspection needs separate examination

CLG has to be forced to model the impact on local government of inspection regimes maintained or supported by the health and education departments. The idea of a single inspectorial giant is misconceived. Political reality dictates the continuation of separate service inspectorates but CLG can at least lobby to diminish their size and cost.

Internal audit must be independent but that does not preclude more adult arrangements for in ol ing councillors

Public spending is accounted for in unitary terms; most local spending is centrally determined; therefore public audit ought to be unitary. The New Audit Organisation proposed above should appoint auditors to all public bodies—further education colleges and schools as well as councils. With external appointment should
go quality assurance and periodical “churn”, allowing comparison of auditor performance. This points to a robust regime with the New

They must address wider questions of public service improvement

A perennial question, whatever the quantum of public spending, is moving public bodies up the ladder of performance, puncturing complacency and instilling principles of service. These are altogether separate from audit. It is highly uncertain whether a “corporatist” approach within local government can work, especially if political tensions rise between central and local government or between councils in the control of different parties. This leaves open the question of who should best attend improvement, and service breakdown. The theory that audit and performance reports would be digested and acted upon by the public crashed on the rocks of indifference, non-participation and party alignment.

rigorous provision of audit needs close monitoring

Within professional circles debate is rife over how separate internal and external audit should be, whether external auditors can be allowed to provide other services to audited bodies. These are especially relevant in the context of heavy market concentration, and the dominance of the Big Four accountancy and organizational service firms—not least when they also have considerable political sway. The New Audit Organisation is going to need tough leadership and dedicated parliamentary support if it is to avoid being captured by the auditors it is meant to chivvy into high quality competitiveness.

Armchair auditors should be encouraged to ask about value for money but their role sharply distinguished from professional audit

Armchair auditing, like the previous government’s enthusiasm for more open flows of public sector data, are to be encouraged—but only up to the point where they complement necessary external and professional scrutiny of the public accounts. Only professional auditors can make sure councils’ trace and tally their revenues and spending. But the public and the politicians they elect are best placed to judge whether a council is doing a “good job”, which may encompass a value for money judgement.

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1 Tom Gash et al, Read before burning, Institute for Government, July 2010.

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5 William A Robson, The District Auditor, an old menace in a new guise, Fabian Society June 1925.

6 For example The Guardian 2 July 1986 “Council ability check: Audit Commission considers publication of annual reports”.


11 Olivier Roth, Through the Looking Glass: Putting citizens at the heart of the assessment process, NLGN July 2010.
THE IMPLICATIONS FOR PUBLIC AUDIT OF THE ABOLITION OF THE AUDIT COMMISSION

INTRODUCTION

1. This memorandum is submitted in response to the Communities and Local Government Committee’s call for evidence for its inquiry on “The audit and inspection of local authorities”. That call for evidence notes that:

   — The Committee will consider future arrangements in all the areas that previously fell within the responsibility of the Audit Commission, including:
     - audit of local authority expenditure;
     - oversight and inspection of local authority performance; and
     - value for money studies.2

2. Whereas the Committee did not construct the circumstances in which this inquiry is being held, that does not diminish their relevance to its deliberations. The brutal manner of the announcement of the abolition of the Audit Commission,3 made on 13 August 2010 during the summer recess and allegedly without pre-informing the Audit Commission, creates suspicions of score-settling and lobbying. There have been other recent instances of the undermining of the authority and independence of public bodies that have various measures of constitutionally necessary independence from the core Executive: the Financial Services Authority; the Food Standards Agency; the BBC; the National Institute for Health and Clinical Excellence; and Ofcom. These convey messages not “to step out of line”, with damage to the ability of such organisations to perform their public functions. Effective public regulation is vitally important to the functioning of a modern society but the instruments can be fragile and require constant nurturing.

3. I have elsewhere analysed the specific features of public audit, which inherently involves difficult relationships:

   “Independence” is the cornerstone of auditing wherever it takes place, but has specialised dimensions when the audited organisation is in the public sector. The wide scope of audit combined with ambiguities in the measurement of performance mean that governance arrangements are substantively important. In the private sector, the principal concern about independence is that the external auditor, engaged in practice by the management of the auditee, can report fearlessly to the shareholders who collectively own that company. The public sector context is more complex: independence is not only from the management of the entity but also from government and other politicians who will pursue private interests as well as advance the public interest (Heald, 2008b, p. 22).

With public expenditure under great pressure for the rest of this decade, the need for well-grounded performance evaluation and Value-For-Money (VFM) work will be greater than ever.

4. The remit of private audit is much narrower, the statutory and regulated segment of “audit and assurance services” being restricted to published financial statements giving a true and fair view in accordance with accepted accounting practice and the audit itself having been undertaken in accordance with recommended auditing practice. Performance measurement (“oversight and inspection”) and VFM studies are not audit matters in the case of a private sector client. Over the past 25 years there has been a remarkable expansion in what public audit has been expected to achieve: this has added to the traditional differentiation that public audit has long gone beyond the certification of financial statements (the core content of private audit) to include “regularity” (expenditure is in conformity with budgetary authorisation) and “propriety” (there has been no fraudulent or inappropriate use of “public money”) (Heald and McLeod, 2002; Treasury, 2007).

5. Public audit should belong to Parliament because of its crucial role in scrutinising the Executive (Heald, 2009), yet it also needs protection from Parliament itself. The dual existence of the National Audit Office (NAO) (Parliament’s auditor) and the Audit Commission stemmed from an era when central government had more respect for the constitutionally separate authority and legitimacy of local government. If there was to be a structural change, such as the abolition of the Audit Commission, Parliament and local government ought to have been centrally involved. In August 2010, it was obvious that, by the time Parliament resumed in the Autumn, the regulatory and operational capability of the Audit Commission would be irretrievably damaged, and that all Parliament could do would be play “catch-up”.

1 Declaration of interest: From 2002 to 2008 I was a (paid) specialist adviser to The Public Accounts Commission. Since 2003 I have been an (unpaid) member of the Technical Advisory Group to the Audit Commission. I hold a chair in Accountancy at the University of Aberdeen Business School. I take sole responsibility for the contents of this memorandum and the views expressed should not be attributed to organisations with which I am or have been connected.

2 Available at: http: www.parliament.uk business committees committees-a-z commons-select communities-and-local-government-committee inquiries audit—com (last accessed 06 01 2011).

3 BBC Radio 4’s da r gr u e (23 August 2010) broadcast revealing interviews, indicating the breakdown of relationships between Ministers and the Audit Commission.
6. There should have been the due process of a Green or White Paper, and then legislation should have been through the vehicle of a public audit bill, not through a general bill (public order ill) whose passage would be dominated by issues affecting Executive bodies. To my knowledge, the only public domain reference to a possible merger of the NAO and the Audit Commission was made in the report commissioned from Mr John Tiner by The Public Accounts Commission (TPAC) (2008, pp. 18–19). This fell outside his terms of reference and did not promote any public discussion, other than the rejection of the proposal for each to have a Non-Executive Director on the other’s Board.

7. During this Inquiry, the Committee should resist the invitation to concentrate exclusively upon detailed operational arrangements. Although extremely important, the kernel of present debates should be the higher level issues to which this memorandum draws attention. I will return to the general context in the final section of this memorandum.

**SUBSTANTIVE IMPLICATIONS**

8. The Government’s announcement about the Audit Commission had three components. First, the abolition of the role of the Audit Commission in appointing auditors and setting the framework for local authority audit, including how that differs from, and extends beyond, the financial certification audit undertaken in the private sector. The framework, set by the Audit Commission, has been a matter of public debate, and outside that, the financial certification audit undertaken by the Financial Services Authority (FSA), in the private sector, has been a matter of public debate, and outside that, the financial certification audit undertaken by the Financial Services Authority (FSA), is likely to be lost. The Audit Commission has been a matter of public debate, and outside that, the financial certification audit undertaken by the Financial Services Authority (FSA), is likely to be lost. The Audit Commission has been a matter of public debate, and outside that, the financial certification audit undertaken by the Financial Services Authority (FSA), is likely to be lost. Some substitute will have to be devised and this is likely to be a matter that the Committee may wish to explore, in the absence of a specific-purpose arms-length body. This is the regulatory function in relation to local authority audit and of major significance for public audit as a whole. Given long-standing trends to diminish the effective autonomy, particularly financial, of English local authorities, and the insensitivities of central government to constitutional relationships, my view is that Parliament has stood aside for too long. The required involvement and influence cannot be secured through after-the-decision inquiries; the Audit Commission should never have been subject to abolition or reconfiguration without advance Parliamentary involvement. The fact that this has happened, and has been treated as a fait accompli, is highly disturbing.

9. Second, there is the privatisation or dissolution of the “District Audit” (ie audit supplier) function of the Audit Commission, with all audits to be undertaken by private sector firms. One of the stated advantages of a mixed model, as also adopted by the NAO, is that having an in-house provider allows for benchmarking against external providers and also provides the operational knowledge base on which the performance of private sector audit suppliers can be evaluated. This will now be lost, giving more market power to the private sector firms and putting great demands on contract specification and management, wherever these functions are performed. This constitutes the substitution of a private provider of audit services for the in-house public provider. The Australian State of Victoria adopted this model in 1998 in relation to the Victorian Auditor-General’s Office, a reform that was later reversed after an unusual amount of public controversy (English, 2003).

10. Without the Audit Commission to devise a Code of Audit Practice and operate a framework agreement under which private sector auditors are commissioned, the market power of those of the Big 4 (Ernst Young have had little involvement in public sector audit for many years) that wish to do public sector audit will increase. For reputational reasons, clients prefer a Big 4 firm as that reduces the chances of being criticised for the choice of auditor, and provides valued blame deflection. Some local authorities may not be able to find a credible auditor, with reputational risks for local government as a whole. The Audit Commission took responsibility for ensuring that councils lacking capacity or with particular problems were handled with care.

11. The “liberation” of local authorities to appoint their own auditors breaches Sharman principles (Sharman, 2001; Treasury, 2002), enunciated after important contributions to the debate on (what became the) the o errnent esources and Accounts Act, made, inter alia, by Robert Sheldon (then Chairman of TPAC) and David Davis MP (then Chairman of the Public Accounts Committee). The focus was on (central government) Executive Non-Departmental Public Bodies but the same principle should apply across the public sector. This principle was created by the Labour Government which had to spend and implement Sharman’s specific recommendations. Parliament did not react when the audit regulatory function for NHS Foundation Trusts was allocated to Monitor and NHS Foundation Trust Boards were made responsible for appointing their own auditors.\(^5\)

12. The third component is the abolition of the research, performance improvement and performance evaluation functions of the Audit Commission, following the earlier announcement of the abolition of the Comprehensive Area Assessment (CAA) and the Use of Resources Assessment (UoR), which extended beyond local government and covered the NHS. Because of their different remits (eg there are many local authorities to compare but only one government department in a functional area), the Audit Commission’s CAA and UoR can be seen as the counterpart to the 60 VFM studies carried out annually by the NAO. If there is a dramatic reduction in the amount of independent performance evaluation work undertaken for local government and the NHS, it will not be long before pressures build up for a curtailment of the VFM work of the NAO. If anyone doubts the hostility of parts of central government towards the NAO, they should read the vitriolic and ill-informed comments on the NAO’s Corporate Plan and Estimates which Treasury officials have regularly sent

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\(^4\) The full range of operational questions to be addressed is set out in Audit Commission (2010).

\(^5\) These decisions clearly had implications for the long-term viability of the Audit Commission.
to the Chairman of TPAC and which are in the public domain. Such capability is easy to destroy but will at a later date prove difficult and expensive to rebuild. Moreover, it is needed in the present, when a long period of strong public expenditure growth is followed by large real-terms expenditure reductions.

13. The abolition of the Audit Commission, and the claimed savings of £50 million,\(^6\) represent a retreat of public audit. The Audit Commission played a valuable role in holding the ring and specifying the nature of local authority audit (certification audit and performance audit, including information on comparative local authority performance). Although closely associated with central government, the Audit Commission had a buffering effect and that increased the legitimacy of audit regulation and performance measurement.

**THE IMPLICATIONS FOR PARLIAMENT**

14. At a future date there may be a repetition of the crises and scandals which led to the development of the existing public audit framework. Immediately ahead, the dislocation may put at risk the conversion of local authority accounting on to an International Financial Reporting Standard basis from 2010–11. This has the potential to create reputational damage. Organisations that approach a scheduled abolition date are vulnerable to disintegration and meltdown, especially if the nature of their activities is such that these cannot be monitored in real time, but only with a considerable lag.

15. Moreover, the issue of relocating the functions of the Audit Commission is only part of a wider picture. My reasons for opposing the new corporate governance structure of the NAO are well-documented (Heald 2008b, 2009). Leaving aside my substantive objections, the legislative journey\(^7\) of these proposals confirms that Parliament collectively has little concern for, or understanding of, the importance of public audit arrangements. As with Parliamentary expenses, this failure to see the link between “governance” and “housekeeping” is intensely damaging to the image and legitimacy of Parliament, and also to its performance in its essential scrutiny role in relation to public expenditure. Even when these links are seen, there is too little willingness to voice these matters in public, leading to a gulf between what is publicly stated and what is privately known and discussed.

16. The implications for the NAO itself are potentially dramatic. The Government’s argument is that private sector auditors are capable of doing public sector audit without the Audit Commission as audit regulator with its own in-house audit capacity. If this view is accepted, then there is no reason for the NAO to employ its own auditors, as all central government audit could also be commissioned and out-sourced. This means that an NAO role in relation to the supervision of local authority audit is a poisoned chalice. If the arrangements do not work, the NAO will be held responsible, though its involvement has been reactive. If the NAO succeeds in making the new arrangements work, then this can be taken as an argument for closing down the NAO’s own audit capacity. If local authorities are “liberated” from performance audit, one would expect central government to seek liberation from the NAO’s VFM audit, a development that would fundamentally affect the work of the Public Accounts Committee. The temptation for the NAO to take on additional tasks at the request of the government of the day manifested itself when it unwisely became involved in the validation of the assumptions underlying macroeconomic forecasts (Heald and McLeod, 2002, para 505).

17. With the benefit of hindsight, the evaluation of public audit fell between two stools: the Executive did not do its job and neither did Parliament. This left scope for lots of undercurrents,\(^8\) erupting into the abolition of the Audit Commission and leaving Parliament unprepared. Despite being a statutory body, TPAC appears not to have been fully functional in the vital period immediately after the May 2010 election, and had no Chairman during the critical decision period during the summer 2010 recess. There has been a characteristically British blurring of responsibilities and accountabilities, on the assumption that things would work out. There is a remarkable contrast between the neglect of these essential matters now and the Parliamentary activism which resulted in the **ational Audit Act**.

18. I will conclude with a practical example of how the architecture and governance of public audit had substantive effects on the important topic of Private Finance Initiative (PFI) accounting:

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\(^6\) I am not aware of the basis for calculation, and that is a matter which the Committee might wish to explore. However, I am doubtful whether competition within the new structure will lead to major reductions in audit fees for financial certification work. Indeed, the opposite might occur for the reasons briefly mentioned above. Significant reductions in “audit costs”, now a loosely-used term, would have to come from reductions on the VFM and performance measurement component. These will be achieved in the short and medium term, but with unknown future implications for service delivery, performance and financial rectitude.

\(^7\) The clauses relating to the governance of the NAO were dropped from the constitution of the NAO.\(^8\) This proposed corporate structure has been implemented on a non-statutory basis. This protracted legislative delay contrasts with what happens when a government wishes to enact its priority legislation.

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What is most striking is the variation in the On Off balance sheet proportions between departments. These differences are heavily driven by the identity of the auditor (the National Audit Office has been stricter about FRS 5A balance sheet treatment than the appointed auditors of the Audit Commission) and the control framework (local authorities and NHS bodies have known that on-balance sheet PFI would not normally be approved). This situation persisted because it suited the Government’s policy of promoting the PFI as a procurement route. This inconsistency was facilitated by the scope for arbitrage between FRS 5A (published by the Accounting Standards Board) and Treasury Technical Note 1 (Revised) (published by the Treasury as an interpretation but which effectively became treated as a competitor standard) (Treasury Taskforce 1999) (Heald, 2008a, Ev.66).

The NAO came under intense pressure to accept the Treasury’s position but the constitutional independence of the Comptroller Auditor General provided a protection for audit judgements that the Audit Commission (a public corporation accountable to a ministerial department) did not have. The majority of private audit firms had no interest in disputing accounting treatment with the Treasury, and indeed had extensive consultancy business advising on how to circumvent FRS 5A.

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Written evidence submitted by Professor Steve Martin

SUMMARY

The Audit Commission’s inspections of local government were costly and time consuming. But there is compelling evidence that its activities helped local authorities to improve their performance and encouraged more effective joint working between local service providers. The decision to abolish the Commission is therefore a gamble which raises some important questions about how to support improvement and strengthen accountability in the future. This memorandum focuses on five issues:

— Faced with the challenge of making large budget cuts and without the external counterweight provided by inspection, there is a risk that the need to increase efficiency will override other priorities and that this will have a detrimental impact of the quality of local services.

— Self regulation and the use of “armchair auditors” are not sufficiently developed to provide credible sources of public assurance or stimuli for improvement.

— It is not clear whether local businesses, voters and other local interest groups will regard performance information provided by authorities themselves as reliable and impartial.
— There is a risk that the area based approach which was encouraged by the Audit Commission and other local inspectorates will be neglected in the absence of “cross-cutting” inspections and that will have a negative effect on both efficiency and local outcomes.

— The abolition of the Audit Commission deprives ministers of a source of authoritative evidence and advice. The Department needs to put in place a coherent strategy for independent monitoring of the impacts of its policies for local government so that ministers can tell whether they are working and fine tune them where necessary.

INTRODUCTION

1. This memorandum has been prepared in response to the call for evidence issued by the Communities and Local Government Committee in connection with its inquiry into the audit and inspection of local authorities. It draws upon the findings of a range of studies undertaken by the Centre for Local Regional Government Research at Cardiff Business School over the last ten years and highlights aspects of the current government’s approach that may merit particular attention by the committee.

THE IMPACTS OF AUDIT COMMISSION INSPECTION

2. The previous government embarked on an ambitious programme of reforms designed to transform the performance and the politics of English local government. Its strategy combined large real terms increases in the level of local government spending with an unprecedented expansion of external inspection.

3. The traditional purpose of inspection was to provide assurance that public services were meeting minimum standards. Under New Labour inspection it was given a new role as an agent of improvement. Ministers argued that “Inspection has a positive role to play in supporting improvements in services” and could act as “a catalyst for better local leadership, confidence, creativity and innovation”.

4. Some observers objected in principle to Audit Commission (and other) inspections of local government, seeing them as an affront to local democracy. Others opposed it on pragmatic grounds. They complained about the costs of inspection and feared that it was distracting staff from the core task of service delivery and causing authorities to focus on national priorities at the expense of local needs.

5. These were legitimate concerns. However on the plus side, the last 10 years has seen significant improvements in councils’ overall performance and increased public satisfaction with local services.11 Many senior local government officers saw Comprehensive Performance Assessments as one of the principal drivers of improvement in their councils,12 and our research has shown that the Audit Commission’s activities had a particularly powerful effect in councils with the most persistent and serious problems.

6. Similarly, although there were some complaints about the way in which Comprehensive Area Assessments were implemented, our research shows that they helped to strengthen partnership working in areas where local agencies had not been able to collaborate properly in the past.13

THE CASE FOR LOCALISM

8. The current government’s approach contrasts sharply with that of its immediate predecessor. It has cut the level of central government grant to local authorities, reduced ring fencing and reined in inspection. And rather than focusing on improvements in local services and outcomes, it policies emphasise the need for greater efficiency.

9. There is a good intellectual case for devolution and strong pragmatic arguments in favour of reducing the level of inspection. Our research has shown that inspection produces diminishing marginal returns over time and as long ago as 2005 we were recommending to the previous government that it adopt a more targeted approach.14 We also questioned whether the very “hands on” approach adopted by the Audit Commission would be sustainable as finances became tighter. Clearly, this is has become an even more poignant concern in the current era of austerity.

10. However, the abolition of Audit Commission inspection is a gamble. Our research suggests that is a need for some form of external stimulus for improvement and check on the performance of local government, and it is not yet clear to us where this will come from in the future.

MAINTAINING THE FOCUS ON IMPROVEMENT

11. There is a real risk that faced with the challenges of making large budget cuts and without the external stimulus provided by inspection, local authorities will lose sight of the need to continue to improve service quality. This could have a particularly detrimental impact on vulnerable groups who tend to depend most on basic local services.

PEER REVIEW AND ARMCHAIR AUDITORS

12. A sector led approach based on peer review has been touted as a possible alternative to inspection, as has the use of “armchair auditors”. However both of these approaches are unproven technologies and neither is sufficiently developed. If they are to stand any chance of success in ensuring adequate service provision and acting as stimulus for improvement both will need to receive considerable additional investment in terms of time and resources and it is not yet clear where this added impetus might come from.

13. The experience of Wales illustrates some of the risks of self regulation. In a recent study we compared the local government performance regimes and rates of improvement in the different countries of the UK. We found that in contrast to their counterparts in England and Scotland, Welsh ministers had eschewed “hard edged” performance management such as inspection and target setting and put much greater faith in self assessment by individual councils and self regulation by the local government sector. Senior policy makers in Wales told us that with hindsight they see this as having been a mistake, and our own analysis of comparable statutory performance indicators shows that rates of improvement in some local services in Wales have been much slower than in England and Scotland.16 Because of these concerns Welsh ministers have taken new powers to strengthen the external regulation of local authorities, just as England has moved decisively in the opposite direction.

14. Similarly, the research evidence cautions against inflated expectations of “armchair auditors”. Surveys conducted by Ipsos MORI over the last ten years show that there is limited public appetite for involvement. Most people are passive recipients of performance data. Only a quarter say that they would to have more of a say about the way in which their council runs things. Thus while the OnePlace website (established by the Audit Commission as a vehicle for disseminating performance) attracted large numbers of visitors, very few of these were members of the general public. Most of the hits came from local authorities, other public bodies, the media and third sector organisations.

TRUSTWORTHY PERFORMANCE DATA

15. Audit Commission inspections provided independent judgements about a council’s capacity and performance which could be used by elected members, businesses, voters and other local interest groups to hold their local authority to account. It is not clear whether they and other local stakeholders will regard performance information provided by authorities themselves as being similarly reliable and impartial. In the absence of the Commission there may therefore be a need to consider how to validate and safeguard the integrity of locally produced data.

ENCOURAGING EFFECTIVE PARTNERSHIP WORKING

16. The role which Comprehensive Area Assessments played in encouraging collaboration has been noted in para 7 above. Cuts in public spending make it even more important that local service providers work together to reduce wasteful duplication by developing shared services and other forms of joint working. There is a risk that budget constraints will exacerbate the strains between organisations in those areas where collaboration has been difficult to achieve in the past. If public agencies lose sight of the area based and outcomes focused approach which the Audit Commission and other local inspectorates sought to encourage through Comprehensive Area Assessments and retreat back to their traditional “silos” this will have a detrimental effect on both efficiency and outcomes.

ENABLING EVIDENCE BASED, ACCOUNTABLE POLICY MAKING

17. The “localism” agenda, and associated reining in of inspection, is a bold experiment in central-local relations which marks a decisive break with the policies of the last three decades. But because it is novel we don’t know what its results will be. We can predict that its impacts will vary between localities and perhaps between services. Localism will almost certainly serve some communities better than others. And like all policies it will have some unintended and as yet unforeseen effects. The abolition of the Audit Commission deprives ministers of one source of authoritative independent evidence and advice about what is happening “on the ground”. It is important that the Department puts in place an alternative strategy for monitoring developments in detail and over time so that ministers can tell whether their policies are working and fine tune them as necessary, and in order that they can give a proper account to Parliament and the wider public.

January

1. Summary

The Association, representing some 9,000 local councils (the Parish and Town Councils) and their 80,000 councillors in England, has a number of concerns about the future of the audit of local government expenditure. These are being addressed in Meetings with Officials and, to assist the Committee, the major matters are set out in some detail below.

The sector provides the greatest single group of “clients” of the Commission but the smallest in value. The needs of the sector are quite specific and the need for proportionality has to be considered in all aspects of the proposals for the abolition of the Audit Commission. There does appear to be a technical activity which needs to be independent of government that is currently delivered by the Commission (with assistance from others). The detailed proposals will need to be “parish proofed” to ensure that they are fit for purpose.

The issues that need clarification and guidance from Ministers and in due course a decision from Parliament are:

(a) What minimum standard of scrutiny (if any) should be applied to these public funds?
(b) What arrangements will be necessary to enable the electors to trigger a raised standard of scrutiny without disproportionate power being given to an individual?
(c) If the Councils are to be able to appoint their own auditors, then what form of quality control will be required? What level of independence of audit partner and staff will be necessary?
(d) Will the proposals deliver a saving in fees or require further funding from the limited resources of the sector?
(e) What arrangements must be made to address the long-standing public audit opportunity for an individual to raise a challenge, question and objection?
(f) How will the Secretary of State obtain satisfaction with the levels of compliance with good governance of public funds in the sector?
(g) How will technical guidance be provided to the sector and to those undertaking scrutiny?

2. Introduction to the Sector

The National Association of Local Councils (NALC) is the nationally recognised membership and support organisation representing the interests of around 9,000 parish and town councils and their 80,000 local councillors in England.

The local councils that the Association support and represent serve electorates ranging from small rural communities to major cities. They are all independently elected, and raise a precept from the local community. Together, they can be identified as among the nation’s most influential grouping of grassroots opinion-formers. Over 15 million people live in communities served by our local councils, around 35% of the population, whilst over 200 new local councils have been created in the last 10 years.

Local councils work towards improving community well-being and providing better services at a local level. Their work falls into three main categories:

— representing the local community;
— delivering services to meet local needs; and
— striving to improve quality of life in the community.

Through a range of powers local councils provide and maintain a variety of important and visible local services including allotments, bridleways, burial grounds, bus shelters, car parks, commons, community transport schemes, crime reduction measures, footpaths, leisure facilities, local youth projects, open spaces, public lavatories, planning, street cleaning, street lighting, tourism activities, traffic calming measures, village greens and litter bins. These existing powers were recently strengthened by the extension of the well being power to eligible local councils.

NALC provides support and advice directly to our member councils through a network of county associations. Working with and for our member councils, we are actively involved in working with, and influencing, government and other bodies at a national level to advance and protect the interests of local councils and the communities they serve.

The Audit Commission has prepared the following table showing the number of smaller bodies involved in total—local councils clearly making the vast majority. (2009–10 figures rounded):
The total spend by local councils is estimated at £500 million of which some £356 million is collected by Precept and thus eventually through the Council Tax. At an average Band D charge of £44–55 this is equal to 86 pence per week per household. (DCLG figures for 2010–11)

The councils follow the requirements of the Accounts Audit Regulations 2003 (as amended) and all have an appointed internal auditor responsible for reporting to council on the strengths and weaknesses of the internal financial controls.

Guidance to the auditors and the sector is provided within the on-line publication “Governance Accountability for Local Councils (England)” which is regularly updated by the Joint Practitioners Advisory Group (JPAG) for which NALC currently provides the chairman. This guidance is drawn up in close association with the Commission staff. Intellectual property rights remain with the Commission but the publication rights are with the National Association and the Society of Local Council Clerks.

3. CURRENT REQUIREMENTS

Parish Town Councils are included in the Audit Commission Act 1998 as bodies requiring an audit under that Act and have to follow the same statutory requirements as all principal local authorities. The Code of Audit Practice (approved every five years by Parliament) sets out the standards of audit that are to be applied. For the vast majority of Councils this involves the completion and approval by the Council of an Annual Return consisting of two published sections with an Auditor’s Certificate and Opinion, and 1 section for completion by the Internal Auditor. The standard applied is that of a “negative assurance”. For those Town Councils with income and expenditure over the £1 million threshold to 31 March 2010 a full “true and fair view” audit has been carried out. It is under discussion as to whether the £1 million threshold can be raised to enable further de-regulation to apply.

Every Council is subject to the conditions within the Act for Challenge, Objection and Question at Audit. Every Council is subject to the same timetable as the principal authorities for approval by 30 June and publication by 30 September each year.

These arrangements were introduced in 2001 following the withdrawal of many of the professional firms from this part of public sector audit provision. The changes put in place then have broadly been accepted and are generally complied with in full.

4. CURRENT POLICY POSITION

Following the announcement by the Secretary of State on 13 August that the Audit Commission is to be abolished, we have been sounding out opinion within the sector on possible future arrangements and, in very recent months, meetings with the relevant officials at the Department have been held. These Meetings have identified the issues and principles on which decisions will have to be made by Ministers. The risk is that the headlines will be the effects and changes for the 500 principal authorities and that the consequences for the 9,000 smaller bodies can be overlooked and addressed as an after-thought rather than as part of the whole.

These discussions, within which we hope to be able to identify solutions that address the political imperative of the Secretary of State as well as the reasonable needs of the sector and the electorate, are ongoing.

5. ISSUES ARISING

(a) Standard dit

The options that could be considered range from “No audit” through a form of “independent scrutiny”, “negative assurance” as at present, to “full audit”. It has been suggested that a system of thresholds would apply.

(b) E et rate in en e

There could be an option for the Parish Meeting (the electorate) to trigger scrutiny at a higher than statutory minimum standard if the Meeting considers that the expense is justified. This would remove the present opportunity for one elector to raise issues and costs as currently used by some for vexatious, trivial and frivolous (often personal) reasons but would leave the option for a well-argued case to be supported. This would produce a similar meeting to a charity or company Annual General Meeting where questions are asked and the annual report and accounts are formally received approved adopted. This might entail a change to the statutory date for the Annual Parish Meeting.
(c) Appointment of Auditor

The issues here are those of sufficient supply and proper procurement. Full Public Sector Audit is a specialised field and is not an area of expertise normally found in the High Street accountancy profession.

There has in the past been a strong quality control exercised by the Commission which has led to a high standard of negative assurance audits. There may be a need for continuity of quality control of the public sector audit to provide central government with the reassurances it may feel it has to obtain.

It remains to be seen whether there needs to be an “auditor of the last resort” for those very few cases where the council deserves a full Report in the Public Interest see below at (e). This could be the Auditor of the relevant higher tier authority in default.

In the past the standard of independence in audit appointments has been of the highest possible standard—there is some concern that local appointments will not be seen as being so independent.

(d) 

Currently the scale of charges is fixed for a five year term according to the value of the financial activity of the relevant council. The returns in terms of fees to be generated may not be attractive to the other suppliers (as found over 10 years ago). The opportunity for local appointment to undertake a full audit appears limited. At present there is an element of subsidy and recognition of the cost of collection of small amounts in those councils below the £1,000 threshold—these councils do not pay an audit fee unless problems are found or issues raised which require more than the standard work for a negative assurance report. There are concerns about the imposition of fees where fees did not previously exist and at small bodies where small values can produce significant percentage increases in Council Tax (arguably for no apparent local benefit).

(e) 

An elector has the right to challenge transactions and governance at parish town councils—this is rarely used but is seen as a safeguard for public funds. Any Challenge will involve considerable expense in professional charges and legal costs. The ultimate sanction being a declaration that a payment is unlawful or that criminal activity has taken place and that matters be referred to the Police for action. These issues can arise during the present audit procedure and do not necessarily come from Challenge by an elector. The auditor in such circumstances will currently have the support of technical and other specialists based within the Commission. In the future there is a risk of uncertainty in addressing the real issues and in separating the frivolous, vexatious and trivial challenges. There has to be a recognition of the risk that poor governance will occur somewhere in a group of some 10,000 corporate bodies. An Auditor’s Report made in the Public Interest is a significant sanction for a local council as the whole of the detailed report is published on-line (by the Commission) and usually sent directly to the local newspaper. The Council is required to respond in public within a set timetable, as well as fund all the additional audit costs arising.

(f) 

The present arrangements include administration of Fees and Returns so that the Commission can be satisfied that an audit has been completed at each parish or town council. Local appointment and the lack of any form of Registration of Councils will mean that the Secretary of State will have no method of obtaining confidence in appropriate levels of compliance in the sector. That is a risk that the Minister will have to consider.

(g) 

Arrangements will have to be made for the continuation of the production of the formal Guidance which currently forms “proper practices” for the purposes of the Accounts Audit Regulations issued by the Minister.

Production of guidance for the auditors and the audited bodies is expensive in time and costs for the few people closely involved. There will need to be some replacement of this provision, currently supported by the Commission from their central operations. The two bodies within the sector (NALC and Society of Local Council Clerks) do not have the capacity in terms of staffing and finance to provide this support at the current level. Both are membership-organisations which suggests that increasing funding for the provision of guidance for the whole sector (ie including non-members) is not sustainable.

6. Relationship with Other Local Government Bodies and Departments

The Audit Commission Act 1998 also applies to Internal Drainage Boards where a similar approach is applied. The Association of Drainage Authorities and the Department for Environment, Food and Rural Affairs are involved.
The Wales Assembly Government and Welsh Audit Office work in parallel with the bodies in England so that the very similar Community Councils in Wales are not treated vastly differently from the parishes in England. The Guidance for Wales is very similar to that published in England.

January

Written evidence submitted by the Chief Fire Officers Association CF A

Executive Summary

1. Fire and Rescue Authorities (FRA’s) are positioned within the local government family given their duty to provide an effective prevention, protection and emergency response service to local communities and to mitigate the risks to life and property as identified through Integrated Risk Management Plans (IRMP’s). FRA’s were subject to Comprehensive Performance Assessments for the first time in 2005 and were included in Comprehensive Area Assessments (CAA) up until the demise of the CAA assessment regime in 2010.

2. The Chief Fire Officers Association (CFOA) broadly supports the submission made to this Select Committee Inquiry from the Local Government Association, particularly in relation to the principles of sector led performance assessment, self regulation and sector led improvement.

3. CFOA believes that Integrated Risk Management Plans form a key foundation by which value for money, performance and risk mitigation should be measured given the underpinning principle of IRMP’s, namely allocating resources according to risk.

4. CFOA supports a sector driven approach to operational assessment and performance given the particular considerations associated with the delivery of an emergency response service in what are often hazardous and risk critical situations. The fire sector has developed and implemented a robust and effective Operational Assessment Toolkit, in conjunction with the LGA and the Chief Fire Rescue Adviser, which has helped to guide improvements in operational performance and delivery. CFOA believes this approach should be encouraged and supported and should add to the body of evidence produced by individual FRA’s to demonstrate effective service delivery to the communities they serve.

5. Over the next few years the financial resources of FRA’s are to be cut significantly due to the pressures on public spending announced in the Spending Review 2010. Any future audit arrangements, either commissioned locally or nationally, need to have regard to the ongoing financial resilience of Authorities especially given that FRA’s are required to contribute to overall national civil resilience in the event of widespread threats e.g. from extreme weather or terrorism.

6. As yet there is little clarity on the future triggers for Secretary of State intervention in any one Authority or any details of who would carry out any such directed inspection intervention where the impact of failure of any one Authority could be very high. CFOA would support the LGA view that intervention should only be initiated once the sector has first had the opportunity to provide improvement support to those Fire and Rescue Services at risk of failure. CFOA believes that the triggers for intervention need to be clear, transparent and communicated to the sector.

The Chief Fire Officers Association

7. The Chief Fire Officers Association (CFOA) is a professional membership association and a registered charity. CFOA members are drawn from all UK Fire Rescue Services representing the senior executives and managers of the Service. Through the work of its members the Association supports the Fire and Rescue Services of the UK in their aspiration to protect the communities they serve and to continue to improve the overall performance of the fire sector. CFOA provides professional and technical advice to inform national fire policy.

The Submitter

8. Susan Johnson OBE was elected to the CFOA Board in 2009 with responsibilities for strategy, policy and guidance relating to performance improvement, resources, governance and statutory responsibilities as they affect the fire sector. Susan is Chief Executive of County Durham and Darlington Fire Rescue Service, appointed in 2005, prior to which she spent a number of years working at strategic levels in the private and public sectors.

Detailed Response

Executive Introductory Remarks

9. The Fire and Rescue Service (FRS) is a locally delivered service and falls within the local government family. CFOA has been developing a sector led improvement framework for the fire, in partnership with the LGA, for over a year in anticipation of a reduction in the regulation and inspection burden and a move to risk based inspection and sector driven performance assessment. The fire sector has delivered year on year improvements in performance and value for money since the introduction of Comprehensive Performance...
Assessment into Fire and Rescue Services in 2005. However the burdensome approach under Comprehensive Area Assessments had begun to negate any positive benefits of external inspection as the focus had to moved more towards “feeding the inspection regime” rather than on driving improvement. Previous performance regimes have also assumed that one size fits all, have been heavy on process and light on outcomes and have resulted in the law of diminishing returns. The sector must be trusted to develop mechanisms which are fit for purpose, which respond to the public need to have visibility on how its service is performing and which takes account of local context. CFOA submitted a detailed review of the fire sector’s experience of CAA to the Audit Commission in February 2010.

10. CFOA welcomes the scaling back of the performance framework and believes that a new approach to assessment, performance and improvement must be owned by FRS’s themselves and be based on robust Integrated Risk Management Planning, provide transparency to communities, be informed by professional judgment, encourage sharing experience and good practice, and be guided by effective leadership and commitment to driving sustainable improvement.

11. The key principles of a sector led approach to performance and improvement are:

   - Sector inclusivity- Every FRS should benefit from the sector led improvement framework and have access to identified support structures to maintain value to communities and the reputation of the sector.
   - Community First—FRA’s are accountable to the communities they serve and strive to understand their needs and mitigate their risks. Therefore FRS’S should be given the first opportunity to address a slowing or adverse change in performance. This organic approach is more likely to be effective, sustainable and less expensive than central intervention.
   - Constructive (critical) friends—From peer reviews to specific interventions must be underpinned through relationship building, openness and trust.
   - Collective ownership of the reputation of FRS UK—FRA’s as a whole need to take responsibility for sector wide successes and problems.
   - Ownership—Improvement is the responsibility of the individual Fire Rescue Authority. No central organisation, or Government, should replace this responsibility.

12. The fire sector has developed a self assessment approach to reviewing the effectiveness of operational delivery through the Operational Assessment Toolkit. Given the risk critical and potential hazardous environments within which the Fire and Rescue Service operates and the contribution which the Service makes to national civil resilience, continuous improvement in operational service delivery and professional standards should be encouraged and form part of the body of evidence that provides assurance to the public of the efficiency and effectiveness of their local fire and rescue service.

Audit of local authority expenditure

13. External audit is important to demonstrate effective stewardship of public funds and sound corporate governance. However, the “whole of government accounting” and the published final accounts produced by public services are totally unreadable by the layperson—and are increasingly too complex even for finance professionals. Whilst it is incumbent on local authorities and other public agencies to present these in a way which is meaningful to the citizen, the recent national prescription on how agencies do this, ie publishing every item of expenditure over £500, could lead to “scrutiny of the weeds rather than the forest”.

14. Over the next few years the financial resources of FRA’s are to be cut significantly due to the pressures on public spending announced in the Spending Review 2010. Any future audit arrangements, either commissioned locally or nationally, need to have regard to the ongoing financial resilience of Authorities especially given that FRA’s are required to contribute to overall national civil resilience in the event of widespread threats eg from extreme weather or terrorism.

15. The proposals that are likely to be implemented following the closure of the Audit Commission regarding the local appointment of auditors are welcomed. However FRS’S should not subsequently be disadvantaged in procurement because of size of Authority and any collaborative Treasury management or commissioning of audit services needs to ensure both transparency of individual agency expenditure and accountability of each agency to the communities they serve.

ersight and inspection of local authority performance

16. The principles set out in paragraphs 9–12 above should apply to the monitoring, reporting and accountability for performance of Fire and Rescue Services. CFOA encourages sector benchmarking informed by sector determined measures, leadership of continuous improvement and fostering a culture of sector support, peer challenge and sharing of support resources and good practice.

17. Since the abolition of national standards of fire cover, the former centralist approach, FRS’S have been better able to provide more effective local solutions to match local risks and needs. The approach to risk management has led to very local solutions and integrated risk management plans (IRMP’S) drive the allocation of resources to risk through a consultative, evidenced based process. IRMP’S have also led to improved community outcomes and stronger partnership working. CFOA believes that Integrated Risk Management Plans
form a key foundation by which value for money, performance and risk mitigation should be measured given the underpinning principle of IRMP’s, namely allocating resources according to risk.

18. Whilst CFOA recognizes there may be circumstances where central inspection or intervention is necessary to safeguard the public, as yet there is little clarity on the triggers for Secretary of State intervention in any one Authority, who would carry out any such directed inspection intervention and who pays. CFOA would support the LGA view that intervention should only be initiated once the sector has first had the opportunity to provide improvement support to those Fire and Rescue Services at risk of failure. CFOA believes that the triggers for intervention need to be clear, transparent and communicated to the sector. Ministers will also require assurance that national interests are protected, e.g. adequate measures to counter terrorism, adequate protection of critical national infrastructure. The parameters of this assurance also need to be clearly articulated.

VALUE FOR MONEY STUDIES

19. Sector commissioned and sector owned vfm tools, that are informed by sector professionals, provide a valuable mechanism to assist robust benchmarking. These have to date been provided by the Audit Commission, albeit with somewhat insufficient input from the sector, and should not be lost to FRS’s. Maintaining these at a national level requires the appropriate level of national funding support to the sector and CFOA and the LGA are carrying forward the discussions with CLG officials as part of the National Functions debate for the fire sector.

20. In recent years some, but not all, of the studies undertaken by the Audit Commission on value for money in the fire sector have resulted in heavy criticism because of the lack of evidence, flawed data, lack of understanding of the fire and rescue service, contrary to other published material and driven by a desire to promote the Audit Commission rather than improve the sector. Other studies, often commissioned by CLG, have taken so long to report that their usefulness in driving vfm or performance improvements has been limited. CFOA would support the commissioning of sector reports, in partnership with the LGA, that are focused on the areas which the sector believes would derive shared benefit and which complement locally commissioned studies. Consideration needs to be given to how these will be funded and CFOA believes that the savings accrued from the reduction in the national audit and inspection regime should be channeled through the sector to deliver these studies.

Written evidence submitted by the Local Government Association

A. THE LOCAL GOVERNMENT ASSOCIATION

The Local Government Association is the single voice for local government. As a voluntary membership body, funded almost entirely by the subscriptions of our 422 member authorities in England and Wales, we lobby and campaign for changes in policy and legislation on behalf of our member councils and the people and communities they serve. We work with and on behalf of our membership to deliver our shared vision of an independent and confident local government sector, where local priorities drive public service improvement in every city, town and village and every councillor acts as a champion for their ward and for the people they represent. www.local.gov.uk

The Local Government Group is made up of six organisations that work together to support, promote and improve local government:

— Local Government Leadership;
— Local Government Association;
— Local Government Improvement and Development;
— Local Government Employers;
— Local Government Regulation; and
— Local Partnerships.

SUMMARY OF KEY POINTS

— Future arrangements for the Audit Commission’s activities need to be set within the context of the Coalition Government’s approach to transparency and stronger local, rather than national, accountability.
— External audit makes an important contribution to the stewardship of public resources and the corporate governance of public services, but the current arrangements are not without the need for improvement.
— Local people and communities should be the primary audience for audit and a simpler and more easily understandable framework for published accounts is required.
— We welcome the proposals for councils to appoint their own auditors.
Communities and Local Government Committee: Evidence

— We fully acknowledge the need for appropriate safeguards to preserve the independence of audit and ensure public trust in the process and outcomes is not jeopardised. But at the same time we need to avoid the possibility that the new approach to audit becomes over regulated and prescribed through Government guidance.

— The scope of audit should in future be more tightly focussed around the accuracy of the financial statements and issues of probity (that the authority’s financial activities are materially free from fraud and corruption).

— The current approach to grant certification is expensive and unnecessary. This spending should be audited through the annual audit.

— There is no need to vest the Commission’s existing inspection powers in another body such as the National Audit Office.

— New arrangements need to be put in place—with the LG Group—to ensure the potential burden of remaining inspection activity on individual councils is managed effectively.

— There is an opportunity to secure improvements in the current approach to value for money studies.

B. CONTEXT AND INTRODUCTORY REMARKS

The Committee’s inquiry comes at an important stage in the Government’s fundamental reshaping of the current performance management framework and any consideration of the future arrangements for the Commission’s activities needs to be seen in that context.

As the Government seeks to replace the current top down performance regime with stronger mechanisms for local accountability it has abolished Public Service Agreements, announced an end to the National Indicator set, announced that Local Area Agreements will not be renewed, brought the Comprehensive Area Assessment (CAA) to an end and, along with the Audit Commission, announced that the Government Offices for the Regions will also be abolished.

We have welcomed this scaling back and refocusing of the current performance framework—much of which we have lobbied for, most recently through our “Freedom to Lead” campaign. It has provided us with the opportunity, working with councils, to develop a new approach to sector self-regulation and improvement which builds on what we have learnt about driving sustainable improvement across the sector. We are convinced that any new approach to assessment and inspection must be “owned” by councils and be based on a coherent set of principles and approaches that is shared by all the bodies inspecting local public services.

The following are the key elements of our new approach.

— **Councils are responsible for their own performance and improvement** and will put in place their own arrangements for monitoring performance.

— **Councils are accountable to local people and communities not to central government or the inspectorates** and will make the performance management information they use to manage their own performance available to the public in a format that local people can understand and use. This will enable local people to hold their council to account and compare their performance against other councils;

— **The role of the G Group is to support councils by providing a range of tools that can be used, as appropriate** These include:
  — advice and guidance to strengthen community engagement;
  — tools to enable local people and communities to participate in regular evaluation of performance;
  — a stronger more flexible approach to peer review; and17
  — a facility to share and compare key performance information across councils and areas.

— **Managing the risk of failure** The Local Government Group will meet with the remaining regulators and Government to receive information about the performance of the sector from their perspective. These meetings will provide the opportunity for local government to reassure the Government that sector-led regulation and support is a much more effective way of addressing performance failures.

— **Further reductions in the burden of reporting, assessment and inspection**
  — The current plethora of data returns and information requirements should be scaled back. Councils spend as much responding to Government and inspectorate requests for data as they do responding to inspection. The onus in future should be on reporting to local people.
  — The approach to adult and child “safeguarding” inspections should be reformed so that they focus on outcomes not process and are risk based and proportionate.

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17 Peer review is the process by which councils invite a small team of members and officers drawn from other authorities (and, as appropriate, from other sectors such as health, police, voluntary and community sector) to review their leadership and corporate capacity or other element of their service provision and give constructive challenge and advice on how to further strengthen what they do. Our experience is that peer reviews are a successful improvement tool and the Local Government Group has long experience of delivering a wide variety of reviews.
In this context we see an important continuing role for financial audit—providing essential assurance to local people and communities that public money is being spent properly. Audit is part of the wider governance arrangements and safeguards provided by Monitoring officers, Section 151 officers and the Annual Governance statement setting out arrangements for good governance.

C. AUDIT OF LOCAL AUTHORITY EXPENDITURE

External audit makes an important contribution to the stewardship of public resources and the corporate governance of public services. It is an essential part of the process of accountability for public money. External audit has had wide and legitimate powers to hold elected representatives to account for over a century—and arguably this becomes more important when public trust in many public institutions is in decline, when the availability of public resources is constrained, and when other elements of the performance regime are streamlined and re-focussed.

However the current arrangements are not without the need for improvement. The scope of the traditional audit function has expanded, there is little evidence that auditors’ reports currently attract much interest and attention from local people and there have been concerns about capacity around treasury management issues. At the same time the Government has announced its proposals to abolish the Audit Commission and reshape public audit.

The audience for audit

We see audit as one of the key mechanisms providing accountability for public resources and agree with the Government that the primary audience for audit and audit reports should be local people and communities, including the voluntary sector and business community.

However the way accounts are presented has become tightly constrained. Councils are required to prepare their financial statements in accordance with international reporting standards (IFRS) with the effect that financial statements become longer and complex.

As the Audit Commission itself has noted: nse ent is ed nan ia in r ati n as e e even re dl t r t e genera i t nederstand (para20, Audit Commission draft Strategic Plan 2010).

A new simpler and more easily understandable framework for published accounts is required that better enables local people to understand the true financial health of public sector organisations and empowers them to hold those responsible to account.

The appointment of auditors

We agree with the Government’s proposals to give councils the freedom to appoint their own independent external auditors from a more competitive and open market among audit firms. This is a practical expression of the localism and devolution agenda and will additionally help drive down audit fees in an era of financial restraint.

It also provides flexibility to consider different approaches. As well as individual appointment—which might be particularly attractive to large councils—other possibilities are opened up as detailed below.

“Area” appointments. In this scenario it might be possible to envisage the joint commissioning of a single auditor to undertake the audit work for key public sector organisations (councils and their local public sector partners) operating within a particular locality. In line with our proposals for structural reform of public finances this approach would:

— make it easier for local people to see what each organisation spends, what it is spent on, and the outcomes that result and to make their own judgements about effectiveness and value for money;
— similarly provide democratically elected politicians—national and local—with the information they need to challenge the effectiveness and value for money of all public services in an area;
— encourage places to bring together their finance functions, giving a further drive to cross organisational efficiency; and
— allow for economies of scale in the appointment process.

This could be locally designed and commissioned from the private sector.

“Class” appointments. In this scenario a class of councils eg shire districts could come together across a discrete geographic area—a county, a sub region, etc—to collectively commission a single auditor to undertake their audit function.

The LG Group will be ready to work with councils to help facilitate any developments along these lines.

Equally we are aware that that there is a possibility that some councils—for example small councils in remote rural areas—may be seen as commercially unattractive and find it difficult to generate enough interest amongst auditors to guarantee a competitive appointment process or could end up paying significantly higher fees than at present. As a result we are in discussion with Treasurer Societies to explore to what extent we can help safeguard value for money in the appointment process by developing framework contracts.
Safeguards: Whilst we welcome the proposed ability for councils to appoint their own auditors we fully acknowledge the need for appropriate safeguards to preserve the independence of audit and ensure public trust in the process and outcomes is not jeopardised.

But at the same time we need to avoid the possibility that the new approach to audit becomes over regulated and prescribed through Government guidance.

We envisage a range of potential safeguards along the following lines.

— **An open and transparent appointment process.** The appointment of auditors would require a decision of the full council on the advice of the Section 151 Officer. Appointments could be for a specific period. The length of the appointment would need to balance the opportunity longer appointments provide to benefit from greater knowledge and understanding about organisations with the potential danger that the effectiveness of audit challenge could become blunted by familiarity.

— **Pen to public scrutiny.** Local people should be able to object to the proposed appointment of an Auditor and lodge an objection which should be considered as part of the formal appointment process; auditors, as of now, would make the results of their audits available to the public; and local people should have the right to inspect the accounts, raise issues about them and question auditors. But future arrangements need to be set within the more recent Freedom of Information, Data Protection provisions and the Coalition Government’s proposed transparency agenda. There is an opportunity to provide local people with a simpler and more coherent set of opportunities to question and challenge.

— **Public interest reports** Auditors would continue to be under a duty to undertake special investigations where concerns are raised about a council and to publish reports, if necessary making recommendations to the council, the sector, inspectorates and or to government.

In addition the National Audit Office would retain oversight of audit across local government, including:

— responsibility for the reviewing, updating and securing parliamentary approval for the Code of Audit practice;

— ensuring the quality of auditors—including developing the criteria for the qualifications of auditors and monitoring and regulating the performance of auditors; and

— dealing with any disagreement between the council and appointed auditor.

The scope of Audit: At its heart, public audit is about providing an independent opinion on the accuracy and honesty of the accounts. But over the years the scope of audit has expanded and now includes a value for money assessment—an assessment of whether organisations have made the best use of the resources at their disposal.

For politically-led organisations like councils there is a real concern that value-for-money assessments begin to encroach on the legitimate role of elected politicians in determining how best to use scarce resources in the interests of their communities and that there is nobody better placed—certainly not private sector auditors—to make these sorts of decisions. Moreover, by the same token, it is local electors who should be the key judges of whether democratically-elected councillors have used public sector resources to best effect.

Neither do we believe that audit should include issues of financial resilience ie having proper processes in place to continue to operate for the foreseeable future and manage potential financial risks and opportunities. This is an essential part of councils’ good corporate governance arrangements which they alone are responsible for and which they would test through regular self evaluation and peer challenge and the wider approach to self regulation described earlier.

For these reasons we believe the scope of audit should in future be more tightly focussed around the accuracy of the financial statements and issues of probity (that the authority’s financial activities are materially free from fraud and corruption)—but not value for money or financial resilience.

We also believe it is time to bring to an end the expensive and unnecessary grant certification work. In addition to the annual audit process some grant paying authorities ask the Audit Commission to certify that the grants paid to local authorities are applied to the purposes for which they were intended.

The Audit Commission charged £19.6 million (2007–08), and £18.7 million (2008–09) in fees for additional certification work. We found that in 2007–08 of the 28 different types of grant claim, only in the case of one grant were the adjustments both substantial in absolute terms and in relation to the cost of the audit. The most recent figures suggest that the situation remains the same; certification of claims amounting to £45.6 billion in 2008–09 resulted in amendments in excess of £1 million in only eight cases.

Councils can be trusted to spend money for the purpose for which it is given, and the cost of providing this kind of detailed “assurance” is an unnecessary luxury. We propose that all spending should be carefully audited, but should only be checked once. That audit should be the annual audit.
D. OVERSIGHT AND INSPECTION OF LOCAL AUTHORITY PERFORMANCE

Whilst the early experience of the Comprehensive Performance Assessment (CPA) certainly helped stimulate improved performance the sector has made a persuasive case that the current approach to monitoring council performance is no longer sustainable. The burden of inspection and assessment activity is simply no longer affordable and there is powerful evidence that separate uncoordinated performance regimes constrain the ability of councils and their local partners to work together effectively at local level.

Whilst the Government has recognized this and begun to dismantle many aspects of the current approach the local public service inspectorates (Audit Commission, Ofsted, CQC, and the three criminal justice inspectorates) retain independent inspection powers. The Audit Commission, for example, has wide powers to inspect under section 10 of the Local Government Act 1999, and the Local Government and Public Involvement in Health Act 2007.

Until recently, the Audit Commission undertook service inspections (of culture, environment, housing and benefits) and crosscutting inspections (access to services, regeneration, community safety) adopting a generic framework requiring self-assessments and assuming 44 days inspectorate time.

More recently these inspections have been replaced by a new risk-based approach where the focus of inspection and the time taken was tailored to the issue under review. Whilst this is a much more proportionate approach the actual number of remaining inspections undertaken by the Audit Commission has been relatively small and as a result we propose that there is no need to vest the Commission’s existing inspection powers in another body such as the National Audit Office.

However we acknowledge that inspection does have a potential role to play in the new approach to sector self regulation and improvement which we set out earlier. In future inspection should:

— be reserved for high risk areas where the impact of failure is high—such as adult and child safeguarding;
— only be undertaken following discussion with the sector about the most appropriate response to poor performance; and
— only be initiated once the sector has first had a chance to provide improvement support.

One of the more valuable functions the Commission undertook in the context of the Comprehensive Area Assessment was to attempt to coordinate inspection and assessment activity across the local public service inspectorates at local level. The Commission acted as a “Gatekeeper” to manage the burden of inspection on individual councils.

Whilst the Inspectorates are under a general duty to work together there is a real danger that this “gatekeeping” function will be lost with the abolition of the Commission.

The Local Government Group continues to receive examples from councils where multiple inspections are taking place simultaneously and requiring the input of council officers for multiple purposes and there is clearly a continuing need to manage the burden on individual councils and areas.

As a result we therefore propose that the remaining inspectorates be required draw up a coordinated annual inspection plan for consultation with the sector through the LG Group.

E. VALUE FOR MONEY STUDIES

The Commission is under a duty to undertake studies designed to help it make recommendations about economy, efficiency and effectiveness and to improve the financial and other management of local public bodies. The Commission has consulted the sector about the annual studies programme. Studies are funded through the audit and inspection fees.

We have a number of observations about the studies programme as laid out below.

— Consultation over the forward studies programme has not always felt meaningful and as a result it has not always been clear that the programme reflects the needs of the sector.
— In the same way sector involvement in individual studies has been variable—and as a result the ability of the sector to help ensure the final product is both meaningful and useful has sometimes felt constrained.
— On occasion it seems that the Commission’s apparent desire to grab headlines when launching individual studies could have distorted the overall message and jeopardized the potential uptake amongst councils.
— Finally, because implementing reports of this nature can consume significant organizational capacity, we think a more effective approach in the future would be to focus on a smaller number of high quality studies.

Whilst we understand that the Government plans to strengthen the National Audit Office’s role in this area, we would like to explore an alternative approach that would:
— involve the NAO studies focusing on improvements to the way in which money is used across the public sector as a whole; and
— create a more locally-focused studies programme commissioned independently of the LG Group but aligned to the Group’s productivity programme, and more general improvement support and best practice activities. These studies could be funded through RSG top slice, a levy from audit fees (as at present) but collected through the NAO, or through savings accruing from the abolition of the Audit Commission.

Local Government Association

January

Written evidence submitted by GA

INTRODUCTION

When the LGA gave evidence to the Select Committee Inquiry into the Audit Commission’s current activities we offered further information on a number of specific issues raised by the Committee. In addition we have subsequently had a specific request for further information on our benchmarking proposals. This submission provides further details on:
— The comparative costs of our sector self regulation approach.
— The role of the Section 151 officer.
— Managing the risk of underperformance and the role of the LG Group political party improvement boards.
— Benchmarking.

THE COMPARATIVE COSTS OF SELF REGULATION

The wide range and complexity of government monitoring, inspection and improvement activity means that it is difficult to identify precisely how much performance management of local government alone cost the public sector—but the costs appear to be substantial and disproportionate compared with other nations.

We believe the costs of the Inspectorates and councils compliances costs to be in the order of over £900 million pa, made up as follows:
— The running costs of the Audit Commission, Ofsted, Care Quality Commission and HM Inspectorate of Constabulary are over £500 million pa
— The cost of the nine government offices—which have an overlapping improvement and regulatory role—is around £127 million pa
— Councils costs of complying with Govt data demands—approx £127 million pa
— Councils costs of complying with inspection—approx £169 million pa

The total figure—when taking Government departmental activity into account—is much higher. In their final report the Lifting the Burdens Task Group cited the Gershon 2006 figure of £2.5 billion as the annual cost of regulating local government from Whitehall. The National Audit Office, in their evidence to the Lyons Inquiry, indicated that the total cost of monitoring, regulating and inspecting local government as £2 billion.

The costs of the LG Group sector owned approach to self regulation and improvement are minimal by comparison—allowing significant savings to be made. The total budget for the LG Group (made up of a mixture of voluntary membership subscriptions, RSG “top slice” and other income) is approximately £50 million for 2011/12. The activities we suggest councils undertake are those that we believe are the mark of mature self aware councils and should not entail significant additional compliance costs. Moreover we know that this approach is effective. Since April 2007 almost 70% of councils have had a peer review and we know that those councils which did so improved their CPA and CAA scores to a higher extent than those councils which did not.

Whilst the Coalition Government’s decisions to abolish the nine government offices and the Audit Commission and bring an end to the Comprehensive Area Assessment will deliver some savings, more needs to be done. Councils are still subject to huge array of demands for data and information from central Government departments which they are increasingly unable to deliver as a result of back office savings. We welcome the ambition to create a single comprehensive list of all data demands on councils but we want to see much more significant progress in reducing the list.

THE ROLE OF THE SECTION 151 OFFICER

The LG Group’s sector self regulation proposals place responsibility for performance and improvement with councils accountable to local people and communities. External Inspection will be retained to provide assurance in high risk areas such as adult and child safeguarding and independent audit will remain to provide reassurance and accountability around the use of public money.
As well as independent audit a framework of other safeguards to ensure high standards of governance would continue to exist through:

— a new duty in the Localism Bill requiring local authorities to promote and maintain high standards of conduct;
— the appointment of Monitoring officers and Section 151 officers required to ensure the legality and financial prudence of decisions; and
— a publically available Annual Governance statement setting out arrangements for good governance (against the CIPFA SOLACE code).

**ROLE OF THE SECTION 151 OFFICER**

Section 151 of the Local Government Act 1972 requires every local authority to make arrangements for the proper administration of their financial affairs and requires one officer to be nominated to take responsibility for the administration of those affairs.

The Section 151 officer is usually the local authority’s treasurer and must be a qualified accountant belonging to one of the recognised chartered accountancy bodies.

The Section 151 officer has a number of statutory duties, including the duty to report any unlawful financial activity involving the authority (past, present or proposed) or failure to set or keep to a balanced budget.

The Section 151 officer also has a number of statutory powers in order to allow this role to be carried out, such as the right to insist that the local authority makes sufficient financial provision for the cost of internal audit.

For further information see CIPFA “Statement on the role of the Finance Director in local Government.”

In addition local people have a range of statutory rights:

— to inspect the accounts, question auditors about them and lodge objections;
— to request information, under the Freedom of Information Act; and
— to make complaints to the Local Government Ombudsman;

and councils have led the way in open government. Meetings are nearly always open to the public (who often also have the opportunity to speak), minutes and financial statements are on the websites.

**MANAGING THE RISK OF UNDERPERFORMANCE AND THE ROLE OF POLITICAL PERFORMANCE PANELS**

During our discussions with the councils on the development of our approach to sector self regulation councils were clear that they wanted to find a way of managing the risk of underperformance since service or organisational failure can have a detrimental impact on the reputation of the sector as a whole—as well potentially impacting on the lives of local people.

At the same time councils were clear that they did not want the LG Group to become a “sector owned” inspectorate—and neither does the LG Group. And we also have to acknowledge the previous top down performance regime was unable to prevent failure and therefore that it would be unrealistic to expect a sector owned approach, costing approx £50 million rather than £2 billion, to do so either.

We are currently developing our approach to managing the risk in discussion with councils and other parts of the sector but it is likely to involve a number of key elements:

— Utilising “early warning signals”. Experience indicates that there can often be early signs that organisations face more fundamental problems. Because of the importance of leadership and capacity in driving organisational performance many such signs can be of a corporate nature.
— Utilising existing sources of evidence to gather intelligence. This could include information and feedback from:
  — Remaining inspection and Audit.
  — Data returns to Government Departments.
  — Locally published and publicly available performance information.
  — Intelligence from professional groupings, the LG Group political Improvement Boards, etc.
— A focal point for bringing the information together and assessing risk:
  — At a sub national level this will be the LG Group’s existing Regional Associates with their capacity strengthened as a result of our current organisational changes. The role of the Regional Associates is to develop close working relationships with individual local authorities at the level of leading members and chief executive so that we are aware of councils that may be facing particular challenges and able to provide support where appropriate.
  — At a national level the LG Group will meet with the remaining regulators and government to receive information about performance of the sector from their perspective. And we have also established a new independent Advisory Board drawing representatives from the key local government professional associations.
The LG Group Improvement Programme Board, working with the other programme boards at the LG Group will maintain an overview of the performance of the sector as a whole.

Each of the party political groups at the LGA recognises the importance that politics can play in the performance of a council. The relationship between the political and officer administration in councils has been shown to be a significant factor that can have an impact on the overall performance of the council. For that reason each of the political groups at the LGA are important in the system of self-regulation and our self regulation approach will continue to make use of the intelligence they hold but also their potential ability to influence and changes things when there may be specific political challenges within a council.

**Benchmarking**

During the development of our approach to sector self regulation and improvement there was a clear demand from councillors and officers to be able to compare performance on key local issues and priorities with other councils and areas since comparative information can help councils understand their own performance and act as a stimulus to improvement.

The National Indicator set—which is being abolished and will be replaced by a single list of all the data that councils are asked to provide to Government and the Inspectorates—did not work in this way. Generally speaking the Indicators reflected performance issues that Government—not local communities—were interested in; a lot of the indicators assessed process not outcomes and many were technically deficient.

LG Inform is a new online service from the LG Group that will allow councils to access and compare key data to help build the evidence needed to make informed decisions, reduce costs and improve services.

**Data:** LG Inform will contain two types of data.

Existing data: LG Inform will contain data covering all authorities from nationally published datasets and the most up-to-date contextual data from central sources, such as the Office for National Statistics (ONS) population estimates. LG Inform will also allow councils to combine this contextual data with their own data (both published and in-year provisional data) for indicators useful to them.

New data: Councils continue to collect information across the services they deliver, and they widely suggested it would be useful to have the ability to make informed comparisons about the issues that matter to them. We are working with councils to develop a core set of agreed metrics around cost efficiency and productivity, outcome and achievements, and citizen satisfaction.

**Functionality:** There will be tools to suit all users, from basic to advanced skill levels, including:

- standard reports presenting data in table and graph forms;
- customisable reports which can be modified by users to include only the data they are most interested in, or the style of tables or charts they prefer; and
- the ability to print, save and share reports.

Users will be able to download the data behind any tables or charts they create, either through LG Inform or direct signposting to other websites. Data can be used within other analytical software if users choose.

**TIMESCALE FOR LG INFORM**

<table>
<thead>
<tr>
<th>January-March 2011</th>
<th>Developing prototype with “learning group” of councils</th>
</tr>
</thead>
<tbody>
<tr>
<td>May</td>
<td>Launch of stage 1 (prototype)</td>
</tr>
<tr>
<td>October</td>
<td>Integrate with Knowledge Hub, with enhanced facilities including a “transparency” option</td>
</tr>
<tr>
<td>April 2012</td>
<td>Develop further productivity measures</td>
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**Written evidence submitted by District Councils etwork**

1. **Summary**

1.1 District Councils in England worked effectively with the Audit Commission through the normal external audit process and through the consecutive processes of Comprehensive Performance Assessment and Comprehensive Area Assessment from 2002 to 2010. With the ending of both these Assessments, and the imminent abolition of the Audit Commission, our comments on future arrangements can be summarised as follows:

- We can show evidence of robust external audit and recommend future similar arrangements, which will ensure continued sound financial management across District Councils.
- Over the past five years, District Council performance has been the fastest improving within the public sector, from an already high base. We commend the LGA proposals for self-regulation and improvement as an important means of maintaining this direction of travel.
— District Councils provide excellent value for money and have sound arrangements in place for continuing this success into the future.

2. DISTRICT COUNCILS’ NETWORK

2.1 The District Councils’ Network (DCN) is a special interest group of the Local Government Association (LGA) and represents the interests of District Councils across England. Some 170 District Councils are members of the Network.

2.2 District Councils across the country are committed to high and improved performance of services delivered locally for their local communities. This high performance, including the control of expenditure and value for money, is recognised as an important, but achievable, challenge over the next few years. District Councils have an outstanding track record of performance improvement on which to base our responses for the future.

3. DETAILED COMMENTS

3.1 dit E terna E endit re

3.1.1 Local Authorities in general, and District Councils in particular, already have proven sound arrangements for internal audit, verified by the Audit Commission and its contracted agents in the private sector. These arrangements could be maintained, in the case of District Councils, by consortia commissioning of external audit from non-public sector firms (accredited by the National Audit Office). By using a broad-based consortia of Districts, the necessary independence of a particular firm from a specific authority can be assured.

3.1.2 The commissioning by District Councils, separate from Unitaries and County Councils in two-tier areas, will ensure that the specific complexities and nuances of District Council activity can be given full and effective consideration by external auditors.

3.1.3 We suggest that an essential element in ensuring the efficiency of such arrangements will be the increasing evidence-based reliance on the rigorous performance and reliability of advice of internal audit work.

3.2 versig t and ns e ti n a t rit er r an e

3.2.1 The LGA, through its Local Government Improvement and Development (LGID) arm, is developing strong and robust arrangements for sector oversight of sector performance, as part of its proposals for self-regulation and improvement. These arrangements will be based on an emphasis on local delivery for local communities and on “benchmarking” relevant to those local services. Using these arrangements, local authorities will have a stronger accountability to their local communities, with more local focus and transparency than was available under the former Audit Commission arrangements. By these means, the divisive nature of media-generated “league tables” is less likely, which should go some way to improving the perception of individual authorities, based on the real local position.

3.2.2 These arrangements will allow the identification of key early warning signals, working within a small number of national targets, balanced between County and local District priorities in two-tier areas.

3.3 a e ne St dies

3.3.1 District Councils have always been committed to value for money for local tax-payers, as evidenced by our being in the forefront of the delivery of efficiencies, whilst continuing to improve performance. It is arguable that the Audit Commission value for money studies themselves, whilst having some use, were not in themselves value for money exercises and did not necessarily produce the desired results, as they were not wholly owned by the local authority sector. The necessity for reducing costs, whilst delivering outcomes for local people, driven by financial stringency, the Localism Bill and increasing transparency of operation, will collectively encourage value for money. This will be enhanced by a greater ownership by local authorities and by the increasing scrutiny of local people, which together will produce the required outcomes far more effectively than former and current bureaucratic arrangements.
SUMMARY
— The broad moves towards decentralised audit and performance management arrangements are welcome.
— There need to be ways to ensure that audit prices remain competitive and that quality is maintained under the new regime.
— There is a role for inspection in relation to services for vulnerable groups—but it needs to be joined-up, risk-based and proportionate.
— There should be greater self-regulation across the local government sector, with centrally-imposed data burdens substantially reduced.
— Value-for-money studies could continue to be useful.

BACKGROUND
1. The County Councils Network is a cross-party special interest group of the Local Government Association which speaks, develops policy and shares best practice for the County family of local authorities, whether unitary or upper tier. CCN’s 38 member councils, with over 2,500 Councillors, serve 24 million people over 45 thousand square miles or 87% of England.

2. CCN welcomes the opportunity to submit evidence to this inquiry. In the months before last year’s General Election, CCN engaged its members in a major policy debate which culminated in the publication in March 2010 of the manifesto. This document sets out the CCN’s vision of a future in which local government, working with central government, can deliver better outcomes for local communities. A key part of this vision was a new approach to local accountability, with councils becoming accountable first and foremost to the people and communities they serve.

3. This submission reflects the principles set out in the Manifesto, applying them to the current context given the significant developments following the General Election. It also takes into account recent discussions amongst the CCN membership and views provided by our member authorities.

INTRODUCTION
4. Since the General Election, there have been a number of significant developments relating to the audit and inspection of local authorities. Comprehensive Area Assessment has been scrapped; Government has announced its intention to abolish the Audit Commission and replace it with a new “decentralised audit regime”; the Place Survey has been abolished; and more recently, Government has announced that local areas would be “placed fully in control” of their Local Area Agreements, and that the National Indicator Set would be scrapped and replaced by a “single comprehensive list” of all local government’s reporting requirements.

5. Alongside this, Government has indicated that it expects councils (along with other public bodies) to become more transparent. The Coalition Agreement states that Government will require “all councils to publish meeting minutes and local services and performance data”, along with “items of spending over £500, and contract and tender documents in full”. The Secretary of State has urged councils to move at speed to adopt this approach.

6. CCN welcomes the broad thrust of these developments, the bulk of which is consistent with our own position on the future of the performance framework and our call for a move towards locally owned performance management and a reduction in the burden for local authorities. We welcome the indications that the bureaucracy associated with inspection and reporting will be reduced, that councils will have greater responsibility for their own performance, and that there are moves to increase accountability outwards to citizens and communities rather than upwards to central government.

7. That said, there remain a number of outstanding issues, including about future audit arrangements and the burden of continuing inspection frameworks. Our thoughts on some of these issues are set out below.

AUDIT OF LOCAL AUTHORITY EXPENDITURE
8. CCN considers that external audit plays an important role in ensuring probity and good governance on the part of public bodies, including local authorities, and in holding these bodies to account. As we move towards a climate in which a greater emphasis is placed upon the transparency of public institutions, it is vital that robust external audit arrangements remain in place.

9. In announcing that the Audit Commission was to be abolished, Government set out proposals for a new, decentralised audit regime. This would include the transfer of the Commission’s audit practice out of public ownership, the strengthening of the Local Government Ombudsman’s powers, and the regulation of audit within a statutory framework overseen by the National Audit Office and the profession. Councils would gain the ability to appoint their own auditors. District auditors would retain a duty for reporting issues in the public interest.
10. CCN supports in principle the move towards a more decentralised approach. This is consistent with the Government’s approach to devolving greater responsibility away from Whitehall and towards local councils and local communities. From a localist perspective at least, the proposal to enable councils to appoint their own auditors is welcome.

11. The government has suggested that this move will enable the driving down of costs by creating “a more competitive and open market”. We would be a little more cautious about the potential for savings. There is only limited number of audit firms acting as approved auditors under the current regime. We cannot assume the sudden creation of an open market in which numerous additional firms have the appropriate skills and capacity to carry out local authority audits. There is the significant possibility that competition will be limited, creating the potential for price rises.

12. The Audit Commission, by contracting with these firms on a large scale and ensuring the smooth management of changes of auditors, has helped to regulate significantly the prices charged. Under the new regime, it will be incumbent upon local authorities to find ways to ensure that prices remain competitive.

13. Potentially the most effective way of doing this will be to explore possibilities for collaboration in the procurement of external audit services. This could involve collaboration amongst groups of authorities with shared characteristics (CCN members for instance), or amongst all types of authority on a regional or sub-regional basis.

14. There is also the possibility of councils collaborating with other public sector bodies to commission jointly a single auditor on an area basis. Such an approach has been mooted by the LGA and would accord with current thinking about community budgets and a place based approach to service delivery.

15. In addition to the price of audit services, the quality of provision—the skills, experience and capacity of the firm—is an important consideration. Audit firms may therefore find it more useful to bid for area or group contracts, as it may assist their operating model in enabling them to assemble an office with the appropriate skills.

16. Moreover, as more authorities move towards shared service arrangements in various forms, a joint procurement approach may help to make the auditing of these arrangements simpler and more cost-effective. The present regime does not properly cater for such models; indeed, because of the requirement to audit joint committees, the audit burden is often increased where shared services are in place.

17. We would stress that any collaborative arrangements should be entirely voluntary and formed on the basis of “consenting” local authorities coming together. We would also suggest that, regardless of whether appointments are made individually or on a collaborative basis, it would be helpful to have in place some form of framework contracts from which authorities or voluntary groupings can call off.

18. CCN suggests there should be a forced rotation of auditors after a given number of years. This will be important for ensuring transparency and avoiding any perceptions of relationships becoming too close.

19. CCN believes that external audit should focus on the accuracy of the accounts and matters of probity. We share the concerns of the LGA about auditors making value for money judgements. It should be for democratically-elected councillors to determine how limited resources can best be spent to meet the needs and priorities of their citizens and communities. We would also question whether it is appropriate for auditors to make judgements about financial resilience.

Oversight and Inspection of Local Authority Performance

20. While in principle supporting the moves towards an area based approach to performance management, CCN had a number of concerns about the way in which the Comprehensive Area Assessment framework was implemented. These included issues about the burden of inspection, the overwhelming focus upon the local authority (and, in multi-tier areas, the county council), and the lack of join-up between inspectorates. CCN therefore welcomed the abolition of CAA and Government’s commitment to a move towards a more locally-owned approach to performance management. We also welcome Government’s announcements that the Ofsted and CQC annual performance assessments are to be scrapped, as we have consistently argued that these were not fit for purpose.

21. There remain, however, a wide range of performance frameworks and inspection regimes linked to functional specialisms. CCN is keen to ensure that these frameworks are also reduced to a minimum, rationalised and aligned to support joined-up delivery between public services at local level.

22. We believe there remains a role for inspection in relation to safeguarding services for vulnerable groups. However, such activity needs to be joined-up, risk-based and above all proportionate. It will be important to identify new, more effective ways of co-ordinating continuing inspection activity in the absence of the “gatekeeper” role previously performed by the Audit Commission.

23. CCN supports moves towards greater self-regulation on the part of the local government sector. Fundamentally, each council should be accountable to citizens and responsible for its own performance. However, we accept that councils also have a collective interest in the performance of the local government sector as a whole.
24. CCN therefore responded positively to the LG Group’s recent consultation on sector self-regulation and improvement, whilst cautioning against the creation of an over-engineered and potentially burdensome new regime. We suggested that the proposals should be broadened to reflect a place-based approach, in line with the current thinking around community budgets. We also suggested that they place much greater emphasis on the role of the overview and scrutiny function to ensure front line councillors play a key role in holding their authorities to account.

25. CCN also welcomes moves to rationalise the data requirements placed upon local government. The National Indicator Set failed to reduce the data burden placed on local government and its partners, was insufficiently aligned with other frameworks, and was focused excessively on process rather than outcomes. Moreover, many of the indicators were ill-defined.

26. We are keen to ensure that these issues are not repeated with the creation of the new list, that it represents a genuine reduction in the data burden, and that local government reports data to central government only where there is a genuine necessity to do so. While data can play an important role in managing performance and in providing transparency, it should be for councils to decide which data to collect in accordance with locally-determined priorities.

27. The draft single data list was published for consultation late in December 2010. In publishing this, CLG released a press notice stating “Councils data demand overload dramatically reduced”. However, the draft list includes some 152 “data collections” beneath each of which is a series of more detailed “data topics”; as it stands, it still represents a significant burden for local authorities, especially at a time when councils are facing major financial challenges and are rightly focused on protecting frontline services.

28. CCN agrees with the LGA that there should be an assumption against Whitehall-imposed surveys and data collection. It should be for Government departments to demonstrate that any information on the list is necessary, explaining why it is needed and for what it will be used.

29. CCN also has some concerns about the impact and input indicators published for consultation in departmental business plans. A significant number of these appear to relate to local government. There is potential for these to place a substantial new burden upon local councils.

**Value for Money Studies**

30. CCN considers the Value for Money Studies to have been one of the more useful areas of the Audit Commission’s work, whilst acknowledging there may at times have been issues about forward consultation and sector involvement. In the current climate, independent studies of this type could continue to be helpful to local authorities. There are a number of bodies that could potentially take on this role, including the National Audit Office, CIPFA and Local Government Improvement and Development.

31. January

Written evidence submitted by local Government network G

**Summary**

**Audit:**
- A new regime for the audit of local authority expenditure must be based around the following principles: transparency, affordability, and effectiveness.
- Safeguards will have to be put in place to ensure that the market for local government audit does not lead to conflicts of interests, increased overall audit fees, or collusion.
- Consideration will have to be given to the “spectrum” of audit, and whether it should include “value-for-money”, to the body most able to undertake such a task.
- With the advent of the Big Society, an increase in shared services and other management reforms, and community budgets, it is imperative for any audit regime to include these dynamics into its remit.
- Attention must also be paid to the internal council mechanisms in appointing auditors, publishing reports, and taking follow-up actions.

**Assessment and inspection:**
- NLGN believes the Local Government family should own, design and conduct risk-based assessment process, with the process being managed by the LGA.
- NLGN recommends increasing the input of citizens as drivers of both priorities and improvement in the assessment process. Furthermore, they should be allowed to petition the Local Government Association for external inspection, flagging up poorly performing services.
- A system of random weighted sample inspections should allow for a risk-based approach to the inspection of services for vulnerable individuals.
ABOUT NLGN AND ITS INTEREST IN THIS POLICY AREA

The New Local Government Network (NLGN) is an independent, not-for-profit think tank that seeks to transform public services, revitalise local leadership and empower local communities. NLGN’s unique networks of innovative local authorities and private companies, voluntary, community and public bodies work alongside the research arm of the organisation to provide thought-leadership and original research into the future of localism and ways to improve public service delivery and re-energise democracy in England.

NLGN welcomes the Communities and Local Government Committee inquiry into assessment, inspection and audit of local government. We are grateful for the opportunity to present our thinking and localism and ways to improve public service delivery and re-energise democracy in England.

AUDIT OF LOCAL AUTHORITY EXPENDITURE AND “VALUE FOR MONEY”

Following the abolition of the Audit Commission as the principal body of local government audit, NLGN believes that special attention should be given to the mechanisms put in its place in order to ensure that the proposed solution will be, on the whole, cheaper, more accountable, and would retain the same level of quality as the previous arrangements. NLGN believes that, unless the process is rigorously examined, problems relating to conflicts of interest and market distortions could arise.

NLGN is committed to the establishment of a transparent process. Transparency should be applied to both the process of audit, in order to ensure rigour and best practice, and the publication of the result of audit, in order to ensure scrutiny and accountability. Transparency can also be a useful tool in increasing citizen engagement and participation in the political process.

NLGN believes that in order for the new regime to achieve the aims outlined above, special attention should be paid to the establishing and running of the local government audit market. Lessons from the private sector, such as the collapse of Enron and the demise of Arthur Andersen, should be heeded. NLGN believes that in order for such a market to function effectively, both the external market mechanisms and the internal local authority mechanisms should be reviewed and analysed.

INTERNAL MARKET MECHANISMS

Considering the budgetary pressures facing local authorities, affordability should be a primary concern in the establishing of an external audit market. The question is whether market competition will automatically result in lower audit fees for the public sector as a whole. Studies from the LSE have shown that audit fees increased by 2.4% following the reduction from five large auditing firms to four, with the near-demise of Arthur Andersen in 2002. Careful consideration is needed, therefore, to gauge the potential impact of the proposed changes and levels of audit fees across the public sector. Costs could be further inflated because of the risks with regards to auditor’s liability, and the need for them to take additional insurance to cover this. Another potential issue is likely to be the location and size of a local authority, and how this will impact on audit fees. Smaller councils or geographically-remote authorities might be forced to pay disproportionately large audit fees due to their budgetary limits, and or the travel costs incurred by auditing firms.

Mechanisms should be put in place to ensure that any conflicts of interest between auditor and auditee are minimised. As many of the auditing firms also provide consultancy services to local government, it is imperative that the process and results of audit are not affected by the relationship between the auditing firm and the local government body. Furthermore, there is currently no provision preventing auditing firms from conducting both external audit and internal audit services to the same authority. Such a relationship could potentially lead to conflicts of interests. This is exacerbated by the fact that, while public services are exposed to wider audit coverage (financial, governance, and Value-for-Money) which currently restricts their need for consultancy, this might not be the case in a future regime. Questions should be raised as to whether this is likely to increase the demand for consultancy by local authorities in the future, and, if so, whether this may aggravate the potential conflicts of interests.

Attention should be paid to the “spectrum” of audit: should the audit be purely financial, to combat fraud and misuse of funds, or should it cover the Value-for-Money angle as well? If it were to have the wider remit, consideration will have to be given as to which entity is the most appropriate to conduct this assessment. While suggestions have arisen that the National Audit Office might be given the “Value-for-Money” aspect of audit, such a shift would raise a series of questions: Does NAO currently posses the resources and expertise needed to carry out such a task? Could such an arrangement lead one day to a Local Authority Chief Executive appearing before the House of Commons Public Accounts Committee, and if so, would this not entail a conflict of accountability? Finally, will the NAO’s Auditor General have the power to criticise either government policy, or Local Authorities’ application of policy?

Local Authorities currently perform their duties in partnership with a range of public, private, not-for-profit and community bodies and groups; with other local public bodies, sharing services with other local authorities, and in arrangements with private and voluntary organisations. The complexity of these approaches may become problematic. If different authorities share certain services, but are audited by different firms, who would audit the shared services arrangements? Aspirations for the “Big Society” and new community responses mean that this level of complexity in service delivery and resource utilisation is likely only to increase. If public money is involved and if services are handed over to specific groups of volunteers, will accounts be audited and reported, and, if so, how? Finally, this problem could arise on an even more significant scale in the case of community-based budgets, which could involve a myriad of funding streams from local and national government and other sources, thus complicating systems of accountability and financial audit trails.

NLGN strongly believes in the principle of transparency, as it should provide a platform for “arm-chair” auditors to inspect the accounts of authorities. This should provide an additional layer of scrutiny, complementing, but not replacing, the audit work carried out by auditing firms.

Examples from abroad have shown that audit of public bodies can be conducted by private auditing firms, but that this market should be regulated. In Sweden, for example, indirectly elected Public Auditors within each municipality are responsible for contracting private auditors to carry out the actual audits, with reports made public to the municipal assembly. The private audit firms work directly for the Public Auditor, as opposed to the municipality itself, and “aid” him or her in their auditing work.

Internal local authority mechanisms

The other angle NLGN believes should be considered relates to internal council mechanisms in both appointing auditors and in dealing with the outcome of audit reports.

NLGN believes that thought should be given as to the person and/or body responsible for appointing auditors: the executive, the full council, or the political leadership. While the full council would possess the required democratic mandate to conduct such a process, this could lead to potential conflicts of interest, as those responsible for overall decision-making would also choose auditors and their terms of appointment. Local taxpayers, as “shareholders” could be given a say in appointing auditors, or in choosing who appoints auditors. Questions must also be posed as to whom the auditors will report to, how this might impact their work, and whether this could lead to conflicts of interests. Additionally, should all reports be made public? Who would have the power to intervene in cases of emergency, or where gross failures are detected?

Assessment and Inspection of Local Authority Performance

NLGN believes that a new inspection and assessment system should be based around the following principles:

— Transparency: Transparency is the most efficient, democratic, and organic way to make elected officials accountable. NLGN advocates for the publishing online of salaries and expenses of elected officials, but also of the financial revenue and expenditure local authorities are operating in, in order to provide citizens with the tools needed to make democratic decisions.

— Centred on the Citizen: Assessment should become a bottom-up process, with citizens defining priorities for areas, and measuring the progress made by local authorities against those priorities. They should act as de a t assessors, and should have a wide variety of options for expressing their views, journeys, and experiences of local services. Citizens should also be provided with the mechanism to petition the Local Government Family if they feel that a specific service is deficient or inadequate.

— Owned by local government: Local Government possesses the democratic mandate and legitimacy, the desire, and the knowledge to organise and oversee self-assessment processes, peer-reviews, mentoring schemes, and best-practice sharing.

— Designed to protect vulnerable individuals: attention must be paid to the most vulnerable sections of society: children in care and vulnerable adults dependent on critical services. This must be achieved through a risk-based, proportional, and efficient system of weighted random inspections for specific services, designed to reassure citizens that vulnerable individuals are being properly cared for and to ensure standards are maintained.

NLGN believes these measures would free councils from the target-driven and regimes installed by previous governments, whilst enabling standards to be maintained and improved. They would place citizens at the heart of the process. They would provide adequate safeguards for vulnerable individuals. They would dramatically reduce the costs associated with previous inspection regimes. Finally, they would foster community empowerment and local democratic engagement by transferring previously centralised power back down to the citizens.
Written evidence submitted by Centre for Public Scrutiny, December 2010

The Centre for Public Scrutiny is a charity dedicated to promoting the value of scrutiny and accountability in the public sector. The bulk of the work that we do relates to local government and the health service.

The main points of our submission are:

— In general the principle of replacing top-down central regulation with local self-regulation and improvement has great merit. However, there are several important caveats to this which are currently not addressed by the government’s proposals.
— Effective local scrutiny mechanisms must be viewed as central to any proposed framework of audit and inspection.
— External auditors should be appointed by the council not the executive and there should be a limit on how long the auditor provides services for a particular local authority.
— There should be an audit committee in each council, but it should not be required to be completely isolated from other scrutiny bodies in the council as there is benefit in linking financial and performance scrutiny.
— The audit committee should be independently chaired, either by the opposition or by an independent co-opted member.
— Councillors should have a clear role in referring concerns expressed by the public over published information for further scrutiny and action where necessary.
— We support the Local Government Group’s proposals on self-regulation, with the addition of a clear role for local democratic scrutiny.
— The local scrutiny function (or in a council with a committee system, some body with some independence from the ruling administration, such as the audit committee referred to above or the local standards committee if the council chooses to retain one) should have a role in signing-off or providing a health-check or validation of the council’s annual report.
— Scrutiny should have the power to refer serious concerns over performance to other agencies, as appropriate, and to “trigger” some kind of intervention, whether in the form of inspection, audit or peer support for improvement from the local government sector.
— The Centre for Public Scrutiny could act as an “honest broker” to assess referrals, ensure they are basically well-founded and recommend an appropriate course of action. This would fill the gap in terms of how to pick up on early warning signs of poor performance which will be left by the demise of the Audit Commission, while leaving primary responsibility for tackling performance at local level where it belongs.
— The Centre for Public Scrutiny Accountability Charter provides a means for local authorities—and other partners—to demonstrate publicly how they plan to make themselves accountable by setting out a number of commitments around accountability, transparency and involving local people.
— The NAO is the natural home for value for money studies but it would require resources and a change to its remit to enable this to happen.

We will address each of the Committee’s three lines of enquiry in turn.

Audit of Local Authority Expenditure

The government’s proposals envisage a replacement of the Audit Commission’s regulatory role in relation to audit with an open market in the provision of audit services to local authorities. They also propose greater public transparency over local authority expenditure, arguing that this will impose greater discipline on council officials, as well as enabling more competition and comparisons to be made in order to drive down costs. There are a number of concerns about whether a free market in audit services will in fact save money or provide the same degree of assurance over public expenditure.

We think that there are some safeguards that—if this path is to be followed—need to be in place at local level to ensure robust and independent audits are maintained. These include:

— The auditors should be an appointment of the full council, not the executive.
— Local authorities should maintain a council (not executive) committee with responsibility for overseeing audit and financial performance. However, we believe that authorities should be able to decide such committees’ detailed remits and not be required to have a separate, stand-alone audit committee if they wish to amalgamate it with a finance and performance scrutiny committee, for example. There are benefits from linking financial audit work with performance monitoring, so that the outcomes of expenditure can be assessed along with the purely financial metrics. CfPS research shows that internal audit functions perceive benefit from a close link with the wider scrutiny function as it raises the profile of audit with members and enables the link with performance to be made (Internal Forms of Review, CfPS 2007).
— The audit committee (whatever its title) should be independently chaired, either by a member of the opposition or by an independent co-opted member.
— Councils should be required to change external auditors every few years to avoid a cosy relationship building up. If the terms of appointment were for three years, for example, it should not be possible to renew this more than once.

— It should be possible for a single audit regime to be provided across different areas of local public expenditure, particularly where there are joint or pooled budgets. Different audit and accounting regimes across local government, health, the police and other branches of the public sector mitigate against effective, efficient—and properly accountable—joint decision-making and expenditure.

In relation to the publication of expenditure information, the important thing is what then happens as a result of the information being published. What can the public do with it, and where and how do they raise any concerns that they may have about what they have seen? Local councillors should be at the heart of this process, as local champions for the public interest, as sign-posters and facilitators and as scrutineers. If there are public concerns about particular patterns of expenditure, local councillors should be able to refer it to the appropriate committee to determine whether it should be fully investigated.

In their overview and scrutiny role, elected councillors provide a route to connect the public’s concerns and views about performance information with the formal decision-making and review process, thus closing the loop and making transparency meaningful. Councillors are also able to make considered judgements in the collective public interest about concerns raised by the proposed ‘army of armchair auditors’. Such concerns about individual items of expenditure may be valid or there may be evidence of the value and impact of this expenditure. Scrutiny should have a role in examining public concerns about published data and assessing whether they are well-founded and whether further more in-depth examination is required. This emphasises the importance of not disconnecting financial audit from performance monitoring—often what will matter to the public is not so much how much was spent but what it was spent on and what was achieved for that expenditure.

**OVERSIGHT AND INSPECTION OF LOCAL AUTHORITY PERFORMANCE**

We believe that the previous Audit Commission performance assessment regime had many strengths and helped to focus attention on performance, with evidence that local government did indeed improve as a result of this regime. However, the time is right to move back from such a centralised and burdensome approach. We support the Local Government Group’s proposals for self-evaluation leading to an annual report, with a three year peer review to provide external validation, as it leaves primary responsibility for improvement where it should lie, with the councillors elected locally to run their council. However, one of the weaknesses of the previous performance regime was that there was a great temptation for local authority administrations to provide a self-assessment for their Comprehensive Performance Assessment or Comprehensive Area Assessment inspection that was overly optimistic and sought to present the council in the best possible light rather than to give a true and honest assessment of strengths and weaknesses. This led to a lack of credibility and created a perception that councils could not be left to self-evaluate.

We suggest that the proposed annual report should be subject to local scrutiny to provide an independent (but local) health-check or validation. This could be combined with involving and engaging local people in contributing their views on how well the council is doing. This should be done in a considered way, and forums which enable deliberative and informed discussion and contributions from a variety of views should be sought. Scrutiny has long experience of handling such exercises to seek a range of views on topics being scrutinised and could be put in charge to ensure the public engagement was carried out independently from the executive of the council. Local health scrutiny committees have also had experience of providing healthcheck commentaries on health trusts’ self-assessment reports for the former Healthcare Commission.

For authorities to be open about their challenges and need for improvement requires them to trust and respect the system that is judging them. This means peers and others who are well-qualified and experienced. It also requires a system where authorities can ask for help privately and not be penalised for weaknesses that they themselves have identified. Where political relationships in councils are mature and effective, they enable constructive challenge to be both made and accepted. For example, a common complaint by scrutineers is that the ruling group or executive controls the activities of majority group members on scrutiny committees. But in some councils, the majority group has chosen not to take up all its places on scrutiny committees, voluntarily denying itself a majority and enabling objective scrutiny to take place without fear of a majority whip being applied. In such councils, the opposition also tends to respond positively to this opportunity and ensures it acts responsibly and objectively.

CfPS is developing an Accountability Charter which will enable all public sector organisations to demonstrate how—in whatever way they consider appropriate to their local circumstances—they plan to be accountable for the public money they spend and the decisions that they make. We think that to strengthen the process of local accountability—as mechanisms for central accountability will become weaker—local authorities should be expected to set out the ways in which local communities will be able to hold them to account, how transparent they will be, how decisions will be made and how they can be influenced, how the public can get involved and how feedback on performance can be provided.

We also believe that local scrutiny functions should have a formal role in being able to “trigger” potential external support or intervention through making a referral to whichever agency would be most appropriate,
depending on the problem. A serious concern about child safeguarding could be referred to Ofsted, a financial issue might be referred to the external auditor, and a wider corporate performance issue might be referred to the Local Government Group for peer support to improve. While we acknowledge that there might be concerns over inappropriate politicised referrals, in such cases, scrutiny (and the opposition, if it was a politically motivated referral) would damage itself for having done so and would lose public credibility. We would also argue that the same thing could be said in reverse about the danger of council leaderships not being wholly honest about their true situation and seeking to conceal under-performance.

As part of the attempt to build a culture of trust and openness, and just as government needs to trust councils to be responsible for their own improvement, councils have to trust local overview and scrutiny committees enough to give them real teeth. We believe that there is evidence of this kind of system already working well in local health scrutiny, where health overview and scrutiny committees have the power to refer consultations on major reconfigurations of health services to the Independent Referrals Panel who then advise the Secretary of State. The IRP have commented that health scrutiny committees have acted responsibly in exercising these powers, which have generally been used only as a long stop, when all local attempts to build consensus have failed. The IRP’s view is that health scrutiny has been “good for everyone”. There were also concerns about the potential abuse of the “call-in” power, when it was originally introduced, but other than in a few cases, by and large it has been responsibly exercised, with the average number per authority remaining low at two to three per year. We believe that this demonstrates that when given real power, scrutiny can be trusted to exercise it responsibly, and that any system of local self-regulation should involve local scrutiny and challenge.

We see this “power to refer” as working in potentially a variety of ways. A scrutiny referral could, for example, trigger an earlier peer review than originally scheduled under the three year programme. Where service risks are identified, scrutiny should have a role in providing on-going challenge to ensure improvement continues. The Birmingham “Who Cares?” scrutiny report is a good example of where scrutiny has acted in a genuinely independent and rigorous fashion to provide challenge and identify the key areas where action was needed to improve children’s services. The press coverage of this scrutiny report (produced by a committee chaired by a member of the majority party) constantly referred to it as “external” and “independent” as if they could not believe that such a hard-hitting report could have been produced by any part of the council. The chair has now been co-opted by the executive to oversee implementation of his committee’s recommendations, and has himself argued that, having been a committee chair in the old metropolitan county council in the 1980s and 1990s, scrutiny provides more power to create change and improve things than the old system.

There are some services—those for vulnerable children and adults in particular—where greater external inspection should still be expected, but it should be more proportionate and risk-based, and always willing to step back where it can be reassured about the strength of local scrutiny. In Cardiff, the Welsh Social Services Inspectorate ultimately stepped down its close intervention and monitoring of a poor social services department, because it was satisfied that the local scrutiny function was monitoring progress against the action plan and performance was improving.

CfPS could potentially act as an “honest broker”, to assess the merits of any scrutiny referrals triggers and advise the appropriate agencies on a course of action, much in the same way as the IRP does over health scrutiny referrals before advising the Secretary of State. We know enough about effective scrutiny to assess whether any referrals were soundly based or not, and could provide reassurance over the risk of malicious or politically motivated referrals. One of the concerns about any new system that may emerge is over how early warning signs of poor performance will be picked up and shared, which the Audit Commission used to provide. Local democratic scrutiny is the best way to pick up on poor performance and make recommendations for improvement, but if their concerns are ignored by a ruling administration in denial or otherwise unwilling to accept their recommendations, then having somewhere to which they can refer serious concerns but which can “triage” the referrals to weed out any that are obviously unfounded and recommend an appropriate course of action, could fill the gap that may be left when the Audit Commission goes.

VALUE FOR MONEY STUDIES

The ability to aggregate and compare data and carry out national studies on performance and value for money was a valuable role performed by the Audit Commission. The National Audit Office is the obvious home for this work, but it will require resources and a clear remit to do so. At present its role is to support Parliamentary scrutiny rather than provide independent commentary on government policy in a wider sense.

The strength of the Audit Commission’s role in this area was the ability to link financial and performance and outcome information. It is important that this happens at local level as well—hence our comments earlier about the value of audit and performance scrutiny being linked. It will also be vital to ensure that in the drive to reduce the burden of reporting on performance, nationally comparable datasets are not lost, otherwise value for money studies will be impossible to carry out in any meaningful way.
Written evidence submitted by psos Mori

SUMMARY

Performance management and independent assessment and inspection have been important in driving improvement across the local government sector

Despite the well documented criticisms of the Audit Commission, in our view Comprehensive Performance Assessment (CPA) in particular, especially in its initial iterations (prior to what appeared to be the sector’s own “grade inflation”), was important in improving visibility of both good and bad performance, and this, with the threat of central intervention, was more effective in improving local government performance than relying on the ballot box alone, or auditors alone.

In considering what may or may not be appropriate in future, we think that some ability for local people, auditors, independent experts and commentators to make fair and public comparisons between the performance of authorities is extremely important. While the process involved needs to be proportionate, our view is that being able to make valid comparisons on performance between authorities, on a public, like for like basis, is vital in driving up performance and highlighting areas for improvement.

Our work for the Local Government Association (LGA) as far back as 2003 illustrated the general support behind the principles of CPA, with the majority of local authority chief executives seeing the assessment as a fruitful process for their authority. Most also agreed that it was an effective way of comparing performance between local authorities and that it challenged their attitudes and the performance of their authority. Most admitted that the sector would not have improved as quickly without some external inspection process. While there were many complaints about the detail of the Best Value and CPA regimes, one thing that virtually all chief executives and local politicians agreed on was that they challenged attitudes and performance.

Do Inspections Drive Improvements?

Q  To what extent do you agree or disagree with the following statements about inspection and audit by regulators and inspectorates:

<table>
<thead>
<tr>
<th>% Agree</th>
<th>% Disagree</th>
<th>Net agree (+/-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Although authorities dislike inspections, it does drive improvement.</td>
<td>80</td>
<td>10</td>
</tr>
<tr>
<td>Inspection encourages a compliance culture instead of driving improvement.</td>
<td>68</td>
<td>24</td>
</tr>
<tr>
<td>Inspection regimes are key drivers of performance for the Authority.</td>
<td>47</td>
<td>29</td>
</tr>
<tr>
<td>If there were no inspections at all my Authority would perform as well as it does now.</td>
<td>25</td>
<td>69</td>
</tr>
</tbody>
</table>

Base:155 council chief executives in England, 4-12 October 2004

Source: MORI

More recently, our evaluation of the first year of Comprehensive Area Assessment (CAA) showed that there was widespread support—from assessed bodies, local partnerships, government departments and inspectorates—for the principles of CAA.

one of this is to suggest that any of these processes were perfect: throughout there were requests for greater transparency over the process, a lighter touch approach, better engagement from elected members and the public, and a concern about the level of cost involved. For example, the survey above saw most authorities agreeing that the cost of inspection outweighed its benefits—views were clearly mixed (see the following chart).
Cost versus Benefit

Q To what extent do you agree or disagree with the following statements about inspection and audit by regulators and inspectorates:

<table>
<thead>
<tr>
<th>% Agree</th>
<th>% Disagree</th>
<th>Net agree (+/-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>63</td>
<td>25</td>
<td>+38</td>
</tr>
</tbody>
</table>

The cost of inspection massively outweighs its benefit to us.

Source: MORI

The public, with no detailed understanding of the costs or processes involved, support cost effective inspection. While few members of the public have ever had a detailed understanding about the ways in which local public services are inspected (17% say they know at least a fair amount), the vast majority 89 feel that independent inspection is important and 80 that it leads to improvements. The public support the principle of independent inspection (as long as it provides value for money—although they themselves find this extremely difficult to judge).

At the same time, our research suggests that the public will not necessarily actively seek out, or remember, information about how their council performs (despite information being available, most people 81 don’t know or can’t remember what the key official judgement of their council was). This does not mean that inspection should be abandoned—the public like to think some independent inspection and regulation is available and expect officers, members and parish councils and others to use this information to improve performance and ask questions. They support frequent independent inspection of old people’s homes, for example.

This is important when we consider current moves to put more performance and spending information into the hands of the public in the hope of mobilising a new force of “armchair auditors”. This has been an ambition of government since Mrs Thatcher’s time (for example, the mandatory publication of performance data in local newspapers happened long before the web was even thought of in this context). But, evidence suggests that citizens are primarily passive consumers of this kind of information, and the desire for this type of information is limited to a small minority of informed and engaged citizens—likely to be older residents, more middle class and owner occupiers.

Moreover, if publication is to be mainly online, because of the continuing class age gradient in internet access (for example, only 18% of working class pensioners (C2DE) are currently online) there will be a considerable challenge in engaging the majority of the population in the scrutiny of public service performance data. We support the current plans to publish much more information online—as a minority of people will find it very useful in holding public services to account—but, we think expectations of the extent to which online publication will directly engage the public can be overstated, although the media and the minority of those active and involved will undoubtedly use it.

Another key challenge is that many members of the public do not trust official statistics and other types of performance information: most think that figures are not reported honestly, or without interference. The public place a lot of emphasis on public information being produced by independent organisations and regulators.

Finally, we would point out that it will be important in any future system for inspection scores to at least resemble public perceptions of performance. Without this, judgements become professionals’ views of other professionals’ services. In its first few years CPA did correlate positively with public perception (although rather fewer of the public would rate their council as excellent or good than would the inspectors). Later, as councils’ “grades” improved, the correlation diminished.

However, our view is that public perception data is a vital part of any inspection regulation system, to encourage services to concentrate on what actually matters to local people, rather than simply counting outputs, or making professional judgements. Having like for like measures is vital if this is to be meaningful. Despite some valid criticisms of the Place Survey (until recently, the key mandatory mechanism used for collecting citizen perceptions data), consultation with the sector has found there to be general support for some kind of standard public perception measurement:
was important to track people’s changing perceptions to help determine whether interventions made in an area resulted in the right outcomes for local people.  

Finally, perceptions data should not be treated in isolation: we would argue that local circumstances need to be accounted for in drawing a fair assessment of a council’s overall performance from it. Our own frontiers of performance analyses demonstrate just how difficult it can be for some councils to achieve high perception measure scores due to the challenging environment in which they operate (with factors such as deprivation, ethnicity and even region impacting on how easy or difficult it is achieve high levels of satisfaction amongst local residents). It showed different types of authorities excelling at different things. Any future process of inspection should use like for like, comparable methodologies, for the measurement of public opinion to allow valid comparisons between authorities and prevent gaming.

The Role of Independent Inspection and Assessment is valued by the Sector

Despite the end of CAA, and its predecessor CPA, it is clear that performance management, inspection and assessment has gone some way to helping strengthen the local government sector, with overall assessment scores improving over recent years. Ipsos MORI research with the local government sector itself backs this up.

We would also argue that CPA provided an important system for recognising good performance and hard work on the part of councils (and equally where poor performance or service failure has needed to be addressed).

Our research into the issues illustrates that local authority leaders and chief executives generally see the assessment and inspection process as both a useful and challenging exercise, and one that helps improvement, despite some of the mechanics of how the respective regimes have worked. Notwithstanding the improvements made to the CPA inspection regime since the research was conducted, a study for the LGA in 2003 found a number of interesting messages still pertinent to the discussion today:

— The majority (three-quarters of county and single tier authority chief executives) saw the CPA assessment as a fruitful process for their authority.
— Most also agreed that the CPA assessment framework was an effective way of comparing performance between local authorities.
— Most thought that the CPA challenged their attitudes and the performance of their authority and that the CPA had a fair amount of impact on their strategic planning.
— The corporate assessment element was well received. The inclusion of peer reviewers in the corporate assessment was highly supported by chief executives, regardless of what CPA assessment score they had received.
— Self assessment was seen as giving councils the opportunity to spend time looking at how they worked, and giving a fair account of their own performance and priorities: it was the most highly regarded component of the CPA process.
— Service judgements were regarded as the least useful element when compared to the corporate and self-assessments, although most chief executives (66%) still found this a useful process. The weaker support for the service judgement seemed to arise partly from concerns about the service blocks identified for assessment and more strongly about the weights applied to them.
— There was some concern about the quality of inspection: opinion was divided on whether the basis for the CPA judgement was clear or not and many were not only doubtful of the evidence, but of the quality of inspectors too.

More recently, our evaluation of the first year of CAA showed that there was widespread support—from assessed bodies, local partnerships, Government departments and inspectorates—for the principles of CAA including:
— the focus on outcomes as opposed to individual services;
— reducing the burden on assessed bodies;
— ensuring that local inspection is a more unified experience;
— giving more emphasis to local context and priorities, and
— taking a more forward looking approach which focuses on risk rather than past performance.

This said, experiences of the stakeholders researched in this study were mixed. For example, there was limited engagement in the CAA process from elected members, the third sector and citizens more widely, with the Place Survey providing the main source of the public’s views. The majority of assessed bodies found both understanding CAA’s approach and staff time spent working on CAA took longer than they expected. Views varied over whether CAA was more of a burden than previous assessments—although most did not believe it had reduced the burden of inspection.

19 The New Place Survey: Summary of responses to consultation, CLG, July 2008
Assessed bodies felt the CAA process was fair although there were concerns over transparency, particularly in terms of the area assessment and criteria and procedures for awarding flags. Nevertheless, red flags were seen to help drive improvement, and there was an interest in learning from areas with green flags. There were mixed views about the neplace website and CAA reports—some organisations thought they were too bland, with too little detail to support improvement. There was a general agreement that CAA had had a stronger focus on inequality and sustainability than previous assessment frameworks. But, there were mixed views about whether there had also been a stronger focus on vulnerable people, and no evidence of CAA having had a greater focus on value for money.

There were a number of views as to how the inspection programme could be improved looking ahead that might be important to consider when establishing any future approach, particularly:

— Having a strong focus on local priorities

— Better engagement from elected members, district councils, the third sector and the public.

— Improving the transparency of the process.

— Ensuring that “underpinning themes”, such as inequality, sustainability, vulnerable people and value for money, are better incorporated into the process. For example, there was considerable support for the development of area based assessments of value for money reflecting the concept of “Total Place”.

— Reducing the burden of inspection through a lighter touch more proportionate approach through, for example, less frequent, risk based organisational assessments and/or area assessments and whole area Use of Resources (UoR) assessments.

**Independent Inspection and Assessment is also Valued by the Public**

Our research shows that the public also values the role of independent assessment and inspection. While few members of the public know about the ways in which local public services are inspected (around 17% say they know at least a fair amount), the vast majority (89%) still feel that independent inspection is important and 80% that it will lead to improvements. The value of independent inspection is also something we note from our research in other sectors, such as our work on policing inspection for Her Majesty’s Inspectorate and Constabulary and education inspection for the Office for Standards in Education (Ofsted).

**The public value independent inspection**

*How important do you think it is that all local public services in England are independently inspected so that the public knows how well or badly they are doing? Would you say …?*

<table>
<thead>
<tr>
<th>Very important</th>
<th>Fairly important</th>
<th>Not very important</th>
<th>Don’t know/ No opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov 2009 (pre CAA publication)</td>
<td>50%</td>
<td>35%</td>
<td>7%</td>
</tr>
<tr>
<td>Jan 2010 (post CAA publication)</td>
<td>55%</td>
<td>34%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Ipsos MORI Base: General public. Wave 1, 20-26 November 2009/Wave 2, 8-14 January 2010
Ev 156  Communities and Local Government Committee: Evidence

And feel it can lead to improvements

Q And, how likely do you think it is that doing this will lead to under-performing local public services improving in the future? Would you say it is …?

<table>
<thead>
<tr>
<th>Certain to</th>
<th>Very likely to</th>
<th>Fairly likely to</th>
<th>Not very likely to</th>
<th>Fairly likely not to</th>
<th>Certain not to</th>
<th>Don't know/ No opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov 2009 (pre CAA)</td>
<td>12%</td>
<td>37%</td>
<td>30%</td>
<td>9%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Jan 2010 (post CAA)</td>
<td>12%</td>
<td>35%</td>
<td>33%</td>
<td>9%</td>
<td>18%</td>
<td></td>
</tr>
</tbody>
</table>

But, whilst people find the principle of inspection important, our research suggests that they will not necessarily actively seek out, or remember, information about how their council performs (despite information being available most people—81%—don’t know or can’t remember what the key judgement of their council was).

Majority say they can’t remember their council’s CPA star rating, and those that do are mostly wrong

Q. The Comprehensive Performance Assessment is an overall star rating of a local council’s performance, awarded by the Audit Commission. As far as you can remember, what was the rating that they gave to your council?

Verified responses:

<table>
<thead>
<tr>
<th>0 stars, 2%</th>
<th>1 star, 5%</th>
<th>2 stars, 5%</th>
<th>3 stars, 5%</th>
<th>4 stars, 2%</th>
</tr>
</thead>
<tbody>
<tr>
<td>5% Correct</td>
<td>14% Incorrect</td>
<td>81% Don’t know/ can’t remember</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Ipsos MORI

Base: General public (784), Wave 1, 20-26 November 2009

We should be realistic about mobilising the public as “armchair auditors”

The issue of engaging the public with this kind of performance information is important when we consider the current argument from government, which is seeking to push more performance and spending information into the hands of the public in the hope of mobilising a new force of “armchair auditors”.

This of course has its merits, but, as our research suggests, are the public really all that interested in knowing what local public services are doing? And do they really trust the information presented to them?
Whilst our research shows that better and more communication is important in helping to improve residents’ overall satisfaction levels with their councils, it also suggests that we need to manage our expectations in terms of just how engaged the public are—and want to be—in monitoring the performance of the sector and in turn holding it to account. Recent polling points to a general lack of awareness amongst the public about how their local public services are performing. In 2010, around two in five members of the public said they had seen information about the performance of their local council. But, only a quarter of people who had seen performance information about local public service providers actively sought it out. This suggests that when it comes to accessing information about how well their local authority is doing, the majority of people remain primarily “passive consumers”.

**Two in five say they have previously seen performance information for their local council**

Q. Have you previously seen any information about how each of the following local public services is performing in your area?

<table>
<thead>
<tr>
<th>Service</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schools</td>
<td>31%</td>
<td>68%</td>
<td></td>
</tr>
<tr>
<td>Hospitals/PCT</td>
<td>33%</td>
<td>64%</td>
<td></td>
</tr>
<tr>
<td>Police</td>
<td>35%</td>
<td>64%</td>
<td></td>
</tr>
<tr>
<td>Fire and Rescue</td>
<td>17%</td>
<td>81%</td>
<td></td>
</tr>
<tr>
<td>Local Council</td>
<td>38%</td>
<td>59%</td>
<td></td>
</tr>
</tbody>
</table>

**Base: General public (784), Wave 1, 20-26 November 2009**

**Source: Ipsos MORI**

But, only a quarter of those who have seen performance information actively sought it out

Q Thinking about the local public services that you saw information on most recently, did you actively seek it out?

- **Don’t know, 1%**
- **Yes, 23%**
- **No, 76%**

**Majority appear to be ‘passive consumers’**

Taking this further, even fewer know about the ways in which local public services are inspected, with three-quarters saying they don’t know much.
Three quarters feel they know little about the ways local public services are inspected

Q. How much, if anything, do you feel you know about the ways local public services are inspected?

- A great deal
- A fair amount
- Not very much
- Never heard of
- Don’t know

2 15% 51% 24% 8%

Base: General public (784), Wave 1, 20-26 November 2009

One consequence of this low awareness is that desire for this type of public information is limited to a small minority of informed and engaged citizens. Based on what we know about those who have accessed performance information in the past, evidence suggests that these are likely to be older residents, of higher social grades and owner occupiers. Many citizens, especially from C2DE social grades, say they are uninterested in tracking the performance of public services, so long as they feel the services are doing their job. This poses a considerable challenge in engaging others in the scrutiny of public service performance data—and those most likely to be the recipients of the high value services provided by local authorities (social care, etc).

Our research suggests that public services need to be realistic about how interested the public will be in becoming “armchair auditors”, beyond the small minority of people who are already well informed and engaged in civic life. We know that the majority of people want to be more informed about public services, but not necessarily fully engaged in their decision-making processes. While most people do consider citizen empowerment to be important, few take up the opportunities in practice.

A majority of the public want information and to have a say, but not to be involved

Q. Which of these statements comes closest to your own attitude towards how local public services (such as the council, the police and local health services) work to improve this area?

- I’m not interested in knowing what local public services are doing to improve the area, as long as they do their job 19%
- I would like to know what local public services are doing to improve the area, but I don’t want to be involved beyond that 47%
- I would like to have more of a say in what local public services are doing to improve the area 22%
- I would like to become actively involved in helping local public services in what they are doing to improve the area 3%
- I am already actively involved in helping local public services to improve the local area 2%
- Don’t know 6%

Base: General public (849), Wave 2, 8-14 January 2010

Research for the Audit Commission about how the public access and use information tells us that that public services need to raise the profile and potential utility of performance information—polling evidence suggests that the vast majority of the public still get this kind of information from the media (39%).
In order to tailor performance information, it is important to understand citizens’ reasons for accessing it, and current access may be low due to people having difficulty translating available data into a picture of performance they can understand. There is also an issue about the medium through which the information is provided, with much coming via online sources still impenetrable to a significant minority of the population. Better tailoring this information to citizens’ requirements may therefore increase access.

Finally, there is an important point to make about trust. In short, public trust in public officials, particularly politicians and government ministers, is lower than any other profession excluding journalists, and in some cases is declining. Trust in councils is also lower than it is for other local services (although Citizenship Survey data suggests that trust levels have been improving here). While the public place a lot of emphasis on public information being produced by independent organisations and regulators, at the same time, they are increasingly sceptical about the legitimacy and accuracy of official statistics produced by both government and independent sources.

**People who trust institutions ‘a lot’ or ‘a fair amount’: 2001 to 2009-10**

![Chart showing trust levels in Parliament, Local Council, and Police from 2001 to 2009-10](chart.png)

Our research into the specific area of local government inspection and performance assessment shows that while the public are positive in principle about being involved in inspection, they generally make little use of inspection reports in part because of an overall scepticism about the usefulness, reliability or authenticity of them. There is a sense that these sorts of reports can be totally divorced from real life, especially where assessment scores do not match their own personal experience. Inspection reports are also seen to rely too much on the filtered evidence statutory services choose to show inspectors—leading to a mistrust of official reports and judgements.

Going forward, there will be clear communications messages to convey about both the potential usefulness and reliability of inspection and assessment reports to local people and communities, and about how robust any judgements will be.

**There is an Important Role for Public Perceptions Measures—but Local Circumstances need to be Accounted for**

Despite a lack of awareness of the wide range of services being delivered by or via local government, as tax payers and recipients of services it is still important that their opinions are used to inform any formal judgements made about local authority performance.

The CAA’s focus on such public perceptions data has been important, as it has encouraged services to concentrate on what actually matters to local people, rather than counting outputs. Despite some criticisms of the Place Survey in terms of questionnaire content and methodological approach, consultation with the sector has found there to be general support for some kind of standard public perception measurement:

> There was a reoccurring theme endorsing the principle of having a questionnaire on place... it was felt that the idea of a regular questionnaire to get local people’s views on matters that affect them was

20 An Ipsos MORI poll amongst Londoners in 2008 showed that while most people knew their council was responsible for picking up their rubbish (97%), local authorities were also thought to be accountable for the local hospital and policing by significant proportions too (by 45% and 49% respectively).

21 There were some concerns about the limitations of using a postal self-completion method, although we do not aim to discuss the issue or merits of survey methodology in this note.
beneficial to help local authorities to address residents’ feedback. It was thought that it was important to track people’s changing perceptions to help determine whether interventions made in an area resulted in the right outcomes for local people.

The New Place Survey: Summary of responses to consultation, CLG, July 2008

However, Ipsos MORI analyses have demonstrated that it is also important to consider the wider context. Some of the criticism targeted at previous performance regimes in the past—from the sector itself—has been around the process of not being flexible enough to truly take into account the priorities of local people and local circumstances. This is reinforced through our *rontiers of performance* analyses, which show that local circumstances have a large bearing on how local public services are deemed to perform by their citizens.

The “peril” in using perception measures is that they are often determined to a large degree by the nature of the population a local authority serves, as much as the local authority itself. For example, our research dating back to our very first *rontiers* report in 2001 shows people’s satisfaction with their area and their council is clearly influenced by local factors such as the level of deprivation, ethnic diversity and the region where they live.

Our latest report, *ind the ap: rontiers of performance in ocal o ernment* (January 2010), attempts to take this into account, by looking at the extent to which perception ratings in different local areas are higher or lower than we would expect given local circumstances (using Place Survey 2008–09 data as a basis). In the simplest terms, our aim has been to level the playing field when considering scores on perception measures, whilst highlighting which councils do best and worst given their local circumstances.

Our *rontiers* report illustrates that a very high proportion of our top performers on the “satisfaction with council” perception measure were also achieving the top grades in CAA—the vast majority achieved a level 3 or 4 (the top score possible) in the latest organisational assessment. This is perhaps reassuring, but it is also clear from our analysis that the highest CAA scores tended to go to those with the highest *absolute* level of satisfaction, rather than those that seem to be most out-performing what we would expect given their local circumstances.

Clearly much more went into CAA than just these simple survey measures, and CAA involved expert professional judgement of services most residents know little about, so we should not expect complete agreement. However, our analyses do illustrate that an essential element of any future regime for inspection and performance management is to recognise that individual areas are unique and local authorities face different challenges. Ultimately, any centrally imposed approach needs to find away of accepting local differences, while at the same time still setting challenging aspirations for perception—which will differ in different areas.

**References**

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DCLG (2001—2009–10): *it enship ur ey*  

DCLG (July 2008): *The ew lace ur ey: ummary of responses to consultation*
Written evidence submitted by the Audit Commission

1. The Audit Commission considers that:

— Public bodies that have tax-raising powers, or which spend large sums of public money, should not be able to appoint their external auditors, a principle first recognised by Parliament in 1864.
— Allowing local bodies to do so would undermine auditors’ ability to work independently and report without fear or favour, key principles of public audit. This would weaken accountability to the public and Parliament for about a third of public spending.
— There should continue to be integrated oversight of the new audit framework; this should include coordination of local audits and provide assurance to departmental accounting officers and the C AG.
— Detailed specifications for a new audit framework, when available, should be objectively evaluated and compared with other options, including the current regime.
— Moving to new arrangements will be complicated and protracted, bringing significant financial and governance risks; it is possible to achieve most of the government’s objectives more quickly, with reduced risk and without major legislation.
— Some of the Commission’s wider functions, which cease on abolition, are valuable. It is counter-intuitive to disband expertise on VFM, data, analysis, governance and assessment when severe financial pressures are increasing the risk of financial or service failure in local public bodies.
— Over the years we have helped local authorities, health bodies, the police and fire services, and social landlords manage their money better, improve their performance, and work with other agencies—to the benefit of local users and local tax-payers. There should be more consideration of the local impact of the Commission’s abolition.

SECTION 1: INTRODUCTION

2. The Audit Commission has four statutory duties: audit, inspection and assessment, value for money (VFM) studies and data matching. Our response covers the three areas specifically mentioned in the inquiry’s terms of reference, but excludes data matching.

3. The government intends to abolish the Audit Commission. This means that our responsibilities for supervising and delivering local audit and inspections will stop, as will our national VFM studies, and our audit practice will move to the private sector.

4. As part of the wider localism policy, the government wants local councils to appoint their auditors. It wants to streamline national performance management of local authorities by government departments and scrap many performance indicators. The government also intends to strengthen local democratic accountability, through transparency of raw spending data, voluntary analysis of value for money (“armchair auditing”), and sector-led improvement.

5. It is not clear whether the government wishes to gather intelligence about local authorities at risk of financial or service failure, or how it would trigger ministerial powers to intervene in the event of failure.

6. We understand there will be no single body with overall responsibility for supervising and coordinating local audit. Instead, different organisations will provide elements of the Commission’s integrated regulatory and auditor support functions.

7. Our inspection and national VFM work includes studies and analysis, comparative information databases and good practice guidance, which support local public bodies, local auditors and inspectors, and central government policymakers.

8. We understand the timetable for the necessary legislation to abolish the Commission, and put in place a new local audit framework, means we are likely to keep some powers until at least December 2013.

SECTION 2: AUDIT OF LOCAL AUTHORITY EXPENDITURE

What does this function achieve?

9. Public money is special. It:

— is raised by compulsory levy;
— can only be used for purposes allowed by law; and
— funds services whose users often have little or no choice.

10. External audit is an essential part of accountability for the stewardship and use of public money. It underpins confidence in the conduct of public servants. Historically, Parliament has recognised that the special accountabilities for public money require a different form of audit from that of private companies.

11. Local public audit is necessary to:
ensure proper accountability—to Parliament, government, taxpayers and other stakeholders—for a third of public spending, over £200 billion; and
— provide assurance that public business complies with proper standards.

12. To achieve these aims, the framework for local audit should comply with the three principles of public audit. Grounded in many years’ experience, the Public Audit Forum of the UK public audit agencies formalised these principles in 1998.

Principle 1: Independence of auditors

13. The independence of auditors is central to the principles of public audit in both central and local government. In 1864 a select committee recommended auditors in local government should be appointed independently. In 1976, the Layfield Committee of Inquiry into Local Government Finance decided it was wrong, in principle, for any public body to appoint its own auditor. The public needs confidence in auditors’ independence when they report on local council spending.

14. Local authority auditors have quasi-judicial functions, for example in deciding on issues referred to them by local electors objecting to items in the accounts. Members of the public are unlikely to consider auditors appointed by local authorities to be sufficiently independent, increasing the prospect of legal challenge.

15. Independent appointment provides safeguards so auditors can:
— carry out their role freely;
— be free from influence by the audited body; and
— report objectively and impartially without fear, or favour.

16. The government has proposed that local authorities should appoint their own auditors. We consider this to be wrong in principle because it undermines auditors’ independence. Those responsible for raising taxes or spending and accounting for public money should not decide who scrutinises how they conduct their business. This is particularly relevant in the political environment of local government, where there is significant public interest in auditors’ reports.

17. Independent appointment remains an essential democratic safeguard. It should be retained. Nevertheless, public bodies could be given more influence over the appointment of auditors.

Principle 2: Wide scope of public audit

18. Public auditors’ work covers the audit of financial statements, as well as corporate governance, including regularity (legality) and propriety (probity), and use of resources (VFM).

19. This wider scope reflects the special accountabilities for public money and the fact that public servants are accountable not just for what they do, but also how they do it. Auditors assess whether public bodies have arrangements in place to ensure the proper conduct of their financial affairs, to manage their performance and use resources well. This helps the public to hold local bodies to account.

Principle 3: Public reporting

20. Appointed auditors report locally, in public through the annual audit letter (which audited bodies must publish), public interest reports, and (in local government) formal recommendations. Audited bodies must consider and respond publicly to public interest reports and formal recommendations. Because they are appointed independently, auditors can deliver uncomfortable messages or report unfavourably on aspects of an audited body’s performance.

21. The government has announced that: “Auditors will retain a duty for reporting issues in the public interest”. In practice, their ability to issue reports may be impaired if local bodies appoint their own auditors. Local authorities often make great efforts to prevent auditors issuing public interest reports, and in some cases have sought to have the auditor removed. Auditors would be less able to resist pressure without the safeguard of independent appointment.

What has the ommission done?

22. As the statutory regulator of the local public audit regime, we oversee arrangements for:
— appointing auditors;
— managing the market for supply of audit and related services;

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22 National Audit Office, Audit Commission, Audit Scotland, Wales Audit Office and the Northern Ireland Audit Office.
23 This paper only addresses the public sector, but there are advocates of independent appointment for private sector companies too. This is often proposed following failures. For example, the recent EU Green Paper on audit in the private sector, Audit policy: lessons from the crisis, asks whether, for the audit of the financial statements of large companies and or systemic financial institutions: “a third party, perhaps a regulator, should be responsible for the appointment, remuneration and duration of the audit engagement, rather than the audited body itself. ... This matter should be explored taking into account, on the one hand, the risk of increased bureaucracy and, on the other hand, the possible societal benefits of demonstrably independent appointments”. European Commission, COM(2010) 561 final, Brussels, 13 October 2010
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— specifying the technical standards for all auditors, including the firms;
— providing technical support; and
— overseeing and regulating auditor performance.

23. These arrangements, which in 2009–10 cost less than £4 million, have secured independent, high-quality, and good value public audit for local public bodies.

Independent audit

24. We have secured auditors’ independence by:
— **Appointing auditors and suppliers** This ensures that auditors cannot be improperly influenced by those whose work they audit. In making appointments, we: consult widely; consider threats to independence, such as those arising from prior business relationships; and create appointment portfolios that are viable—professionally, practically and economically.
— **Meeting auditors costs** We meet all audit costs from the fees levied on local government and NHS bodies. By underwriting costs, we ensure auditors cannot be constrained from meeting their statutory responsibilities by lack of resources. Equally, they cannot overcharge.
— **Limiting non audit services** Lucrative contracts for consultancy could compromise the independence and objectivity of auditors. We monitor non-audit services and must approve any that exceed a threshold.24

Consistent audit

25. Auditing local public bodies is a specialised business reflecting complex legal, governance and financial controls. In local authorities, this includes considerations of legality, responding to local electors and reporting in public. We only appoint auditors with the necessary technical knowledge and expertise. We also oversee quality, challenge inadequate audits and investigate complaints about auditors.

26. We have a statutory duty to prepare Codes of Audit Practice25 prescribing how auditors should carry out their work. We also:
— specify work to certify grant claims and returns for government departments;
— coordinate regime-wide responses to emerging issues; and
— coordinate auditors’ work for key stakeholders with an interest in financial management of local public bodies, including the Department of Health and the NAO.

27. Public auditors apply the same professional standards to audits of financial statements as private auditors. But there are no private standards covering the wider aspects of public audit, for example on VFM arrangements and legality. We provide extensive support through detailed guidance and advice, technical forums and directories, and a helpline.

28. As a regulator, we provide assurance that audits meet the required standard to audited bodies and other stakeholders. These include accounting officers of departments who are accountable to Parliament for the money disbursed to local public bodies. The NAO receives assurance for its audit of departments’ resource accounts and the whole of government accounts. We also act as a single point of contact for coordinating the work of local auditors, for example on grant claims and returns.

Value for money of audit

29. We have secured significant economies of scale. As the largest buyer of audit from the private sector in the UK, we have used bulk buying power to secure good value for audited bodies and taxpayers.26 The Commission’s procurement exercise in 2006–07 realised savings of £30 million over five years. In 2010, the Commission renegotiated these contracts to save a further £11 million up to 2016–17. Audited bodies had no procurement costs, paid lower fees and received rebates. The firms had lower bidding costs and certainty of work, which they reflected in prices.

30. Within the specialised market, we ensure there are enough suppliers of acceptable size to guard against the risk of market failure or reduction in providers. Suppliers can sustain delivery and investment.

31. By managing the market for supply, we ensure that all audited bodies have a competent auditor at a reasonable price. The same audit fee scale applies to similar councils whether close to cities or in remote rural locations, even though audit delivery costs vary significantly. We have also constrained the cost of auditing to the smallest bodies. Twelve hundred small parish councils pay no audit fee. Without our approach, some bodies would face much higher fees, potentially out of proportion to their budgets.

24 Currently the higher of £30,000 or 20% of the audit fee.
25 Both Houses of Parliament must approve the Code at five yearly intervals, and auditors have a statutory duty to comply with it. Parliament approved the current Codes on 9 March 2010.
26 This is consistent with the principle underpinning Sir Philip Green’s recent recommendation that the government should consider “Mandating centralised procurement for common categories to leverage buying power and achieve best practice”. f ciency e iew by ir hilip reen: key ndings and recommendations, Cabinet Office, October 2010.
32. In an open market, private sector auditors can decline an audit, perhaps because it is too risky, or because its size or location makes it commercially unattractive. Our current mixed economy, including our in-house practice, means that every public body has access to effective audit. The market is not homogeneous—many audits are commercially unattractive—but under their contracts with us, firms must accept a portfolio comprising both more and less attractive appointments.

33. Firms contract with the Commission, rather than with individual audited bodies. We regulate the regime and indemnify them for litigation costs arising from the exercise of their powers. This significantly mitigates the risks for audit suppliers, avoiding costs that would be factored into fees.

What needs to be considered for the future?

34. We accept the government’s proposal to move the work of the Commission’s in-house audit practice into the private sector.

35. In future, audit regulation will continue, but not by a single body. As we understand it, the proposal is that, for local authorities, these functions should be distributed to different bodies. These may include the NAO, the profession (the Financial Reporting Council and the professional institutes) and audited bodies themselves. The proposals are still being developed, so options have not been subject to cost benefit analysis.

36. Significant issues remain to be resolved, in particular arrangements for the certification of grant claims and returns and the audit of small bodies.

37. There is a strong case for retaining a single body (not necessarily the Commission) with responsibility for appointing auditors, regulating the audit regime, managing the market for supply, specifying the technical standards, providing technical guidance, and monitoring and regulating auditors’ performance. To date there has been no evaluation suggesting these tasks would be better carried out separately by different bodies. At present, there is a significant risk that the whole will be less than the sum of its parts.

38. It is possible to give most local public bodies more influence over the appointment of their auditors and open the whole market to the private sector with minimal legislative change. This would meet most of the government’s objectives.

39. Maintaining a single oversight body with responsibility for making auditor appointments would also retain the strengths and practical advantages of the current arrangements—which are widely recognised by the accountancy profession, the firms and finance professionals in local government and the NHS. These include:

- ensuring auditors’ independence to act without fear or favour;
- enabling local public bodies to benefit from the firms’ current contracts, by transferring them to a successor body;
- retaining the benefits of bulk procurement to minimise costs;
- avoiding the additional safeguards necessary for local bodies to appoint their auditors;
- maintaining consistency of audit approach across the sectors; and
- eliminating the “hidden” costs to the NAO and departments of coordinating the work of auditors.

40. A single oversight body would also facilitate the transfer of our audit practice to the private sector, by providing an opportunity to win contracts through competition, which would determine its commercial value.

SECTION 3: INSPECTION AND ASSESSMENT

What does this function achieve?

41. Inspections can review many aspects of public services, starting from the experience of service users. They can cover:

- professional standards;
- responsiveness to the public;
- performance;
- governance; and
- VFM and outcomes (including through collaboration).

42. Inspection is often confused with audit, but it has a very different purpose and approach. It is based on the standards and practice of service professionals, rather than accounting standards and practice.

43. Inspection can serve a number of different purposes including:

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27 The Department of Health is considering what audit arrangements should apply to GP consortia; arrangements for police commissioners have yet to be announced.

28 Inspections, as carried out by a number of bodies, are undertaken in accordance with an overriding set of principles agreed by the public sector inspectorates and published by government. Our inspection regime complies with the Regulators’ Compliance Code, which put into practice the findings of the Hampton Review.

— Safeguarding the vulnerable—reviewing whether minimum standards are met and highlighting inadequate services.
— Identifying and mitigating risk of poor performance—motivating managers to prevent service failures and reporting on improvement.  
— Substituting for absent market stimuli—compensating for the lack of competitive pressures and representing customer interests where they have limited scope to influence service standards or choose supplier.

44. It is for government to determine what to inspect, how to inspect and what resources to allocate. Inspections are sometimes part of the performance framework, or alternatively triggered by failure. Inspections can be scheduled well ahead, or inspectors can arrive at short notice. They can be broad-ranging, or narrowly-focused on priority areas. They can involve peer reviews or customer inspectors.

45. Unlike audit, there are no international standards or common methodologies for inspections. This is a strength; by drawing on professional experience, inspection has been adapted flexibly to a wide range of issues and applied across multiple organisations. But there are also weaknesses; multiple assessments by different inspectorates can be bureaucratic and burdensome.

46. To be credible, inspection must be done by independent, skilled people, using a method that is widely accepted. Inspectors need suitable powers, selection, training and professional support to deliver evidence-based judgements in which the public has confidence.

47. Published reports, often highlighted in the media, inform citizens about local services. Inspection therefore strengthens public bodies’ accountability to local people.

What has the Commission done?

48. We have inspected local services since 1996. Legislation changed our remit frequently. In response, we developed approaches based on the experience of users, proportionate to risk and focused on improvement. We reported all our findings publicly, with summaries for the general public and more detail for public servants.

49. When the intention to abolish the Commission was announced, our inspections included:
— landlord services provided by councils, arms length management organisations and housing associations, commissioned by the Tenant Services Authority;
— local authority strategic housing;
— police authorities, jointly with Her Majesty’s Inspectorate of Constabulary;
— fire and rescue authorities;
— housing and council tax benefit services, commissioned by the Department for Work and Pensions; and
— corporate governance inspections, undertaken rarely, the most recent being in Doncaster last year.

50. These can recommend that the Secretary of State for CLG should use intervention powers.

51. Legislation also required us to assess the performance and capacity of local bodies and, latterly, multiple bodies in areas. These assessments uniquely incorporated auditors’ financial judgements and the judgements of specialist inspectorates. There were two assessment programmes:
— Comprehensive Area Assessment (CAA) replaced CPA in 2009, commissioned jointly by four secretaries of state. It ceased in May 2010. CAA provided a joint assessment by six public service inspectorates of how well services, working together, were delivering for their communities on agreed local priorities.

52. Independent research shows that published assessments stimulated improvement in local services. The assessments compared performance in individual organisations or areas with that of others. Support was given to poor performers to help them improve. High performers were identified and encouraged to share their successes. Assessment also created peer pressure for improvement and increased local accountability.

53. Prior to the announcement of our abolition, we were working to develop an early warning system to identify potential failure.

29 Audit provides a similar function for financial failure.
30 Audit applies to the accounts of a single body.
31 The Audit Act 1996 introduced joint inspections of social services with funding provided by the then Social Services Inspectorate. Subsequently we were given a role in joint inspections of local education authorities working alongside Ofsted looking at VFM in local education authorities.
32 Audit Commission, Care Quality Commission, HMI Constabulary, HMI Prisons, HMI Probation and Ofsted.
33 For example: oined up oicy in ractice? The oherence and mpacts of the ocal o ernment odernisation Agenda, James Down and Steve Martin, Cardiff University, August 2006. AA: An e aluation of year one, Shared Intelligence, 2010
54. We increasingly targeted inspections on risk, ensuring they were proportionate. As a result, local authority inspections reduced to 67 in 2009–10, from a peak of 650 in 2002–03.

**What needs to be considered for the future?**

55. The government intends to reduce inspections across local government further. Education and social care are likely to be the main priorities. There will be no overall assessments of broad performance and no risk-based inspections of other council functions.

56. The government plans to reduce the accountability of local authorities to central government by ending local area agreements and reducing performance information, inspection and assessment. It intends that citizens will hold public bodies to account through greater transparency of local data and information. Local democracy, greater choice, community ownership and better complaints procedures will strengthen accountability. Competitive pressures and new forms of ownership (including mutualisation) will encourage improvement. The sector is expected to stimulate self improvement, supported by peer review.

57. While these mechanisms each have a role, they also have significant limitations. For example, the transparency agenda has focused on raw data, especially unaudited spending data. Publishing this discourages waste, encourages freedom of information requests and attracts media interest. But it lacks context and local people (or third parties such as the media) cannot judge service performance unless they know more about the reasons for spending, what it achieves, and what comparable bodies spend and achieve. The requirement for local authorities to provide comparable performance information has been reduced, and there will be no formal assessments that integrate the findings of auditors, inspectors and research.

58. People will struggle to judge VFM in complex areas, for example those which involve multiple public, private and voluntary bodies working together. They will not be able to identify when saving by one body increases costs for another. Third-party commentators will interpret data, but may have their own agendas. We are concerned that local accountability will not be enhanced without improvements to the accuracy and comparability of published data, and local context.

59. It is counter-intuitive to disband expertise on information, governance and assessment when financial pressures mean that the risk of service failure is increasing. The effectiveness of proposals for sector-led improvement with peer review is unproven. With the Commission’s abolition:
   - The government will lose a lever for addressing failure; corporate governance inspections are an important power for tackling failing local authorities.
   - Pressure to achieve standards in some key services, especially housing and benefits, will be reduced.
   - There will be less incentive to achieve better performance and VFM across organisational boundaries or geographic areas—and less knowledge of how to do so well.

**SECTION 4: VFM STUDIES**

**What does this function achieve?**

60. The Commission has a statutory responsibility to carry out studies, under the Audit Commission Act. This duty requires us to study and comment on the impact of central government legislation, regulation and direction on the ability of local authorities to deliver VFM. The government has announced the Commission’s research role is to be abolished.

61. Policy and practice are more effective when based on evidence. Independent research and analysis is particularly important in complex or sensitive areas of policy, where the interests of tax-payers, users and service providers often diverge.

**What has the Commission done**

62. Our statutory national studies define VFM and how it can be improved, providing the foundation for much of the work of auditors and inspectors. They also provide both local public bodies and national policymakers with comparable data, evidence and guidance on achieving better VFM. Before the abolition announcement, the studies budget was around £5 million.

63. Our studies cover both national and local perspectives, to identify how well they interact. We review many different services to identify changes that will deliver improved economy, efficiency and effectiveness. This includes how individual services or bodies are managed, but also how whole systems work. Our studies are not primarily designed to pass judgements retrospectively, but rather to see how local services can improve and deliver better VFM in future. Research methods include primary research and new analysis of data.

64. Our research and analysis has:
   - **Addressed complex and sensitive subjects** We have covered topics on which independent evidence was needed, such as local government pensions, the financial implications of the ageing population, and waste disposal. Many studies have addressed subjects that cross the boundaries between public bodies, a frequent cause of waste and poor performance.
— **sed our local presence to build the national picture** Our studies are based on unique access through local auditors and inspectors. Many of them draw conclusions based on surveys of auditors which can have near 100% response rates, significantly higher than the norm and providing a full picture. Using this method we collected real-time data to identify how well local authorities were responding to the recession, and what lessons could be learned from the best.

— **dent ed action for central government** We have highlighted where government policy could be reviewed to help local bodies deliver better public services. For example, we demonstrated difficulties for local bodies caused by different departmental policies for children’s trusts.

— **Showed how to improve FM.** We have identified many ways to improve VFM. For example, we identified how local authorities could: save on back office functions; use market competition more effectively; commission better from the third sector; and divert young people from anti-social behaviour. Recently we showed how the police could save around £1 billion, without affecting services to the public, by changing workforce mix and shift patterns.

65. Studies have a clear focus on improvement. As well as highlighting good practice and how to achieve it, most include tools to help local authorities save and improve. These can include comparative data for benchmarking, self-assessment questionnaires and tools which support joint working.

66. Our analysis has been incorporated into methodologies used by auditors and inspectors.

**What needs to be considered for the future?**

67. The combination of in-depth, independent, evidence-based research, practical application and consistency over time makes our studies distinctive. The link between national research and local audit and inspection work will cease, losing benefits that other research organisations cannot replicate.

68. It is counter-intuitive to disband expertise on VFM, data and analysis when local authorities face severe financial pressures. Ministers and Parliament should consider whether and how to replace the following:

— **n depth, accurate, comparable information** Our VFM reports are based on aggregate local data that enables credible comparison between councils.

— **ecommendations for central government based on local experience** Independent from government and drawing on evidence from our auditors and inspectors, studies provide analysis informed by a unique insight. Many have addressed the disjointed nature of national policies when implemented locally.

— **Practical tools for local authorities, including benchmarking data** Our tools have been widely used by local bodies seeking to improve VFM.

— **Audit and inspection guidance** When reviewing local authorities’ arrangements, auditors and the remaining inspectorates will lack analysis and comparative tools for assessing VFM derived from national research.

**SECTION 5: CONCLUSION**

69. This paper has discussed three of the Commission’s main functions: audit, inspection and assessment, and VFM studies. While these have been undertaken using different statutory powers, we have achieved greater impact from integrating our different activities. They have each drawn from, and contributed to, the others.

70. This has particularly enhanced our ability to identify ways to improve services and VFM, both locally and nationally. This unique approach will cease when the Commission is abolished.

71. Since the announcement of our abolition on 13 August 2010, most discussion has focused on future audit arrangements. Little has been said about the gap that will be created when a major agency simply ceases to exist. For 27 years we have worked with local authorities, health bodies, the police and fire services, and social housing providers to help them manage their money better and improve their performance. We have encouraged cross-agency working to the benefit of users and tax-payers, and helped mitigate the effects of failure.

72. The independent judgement of auditors and inspectors, based on evidence and research, acts as a catalyst for effective and efficient public services. Since most of our reporting is directly to local bodies and local people about local issues, we are significant contributors to the local accountability of local public services to local tax-payers and users.

73. A number of commentators have expressed a view that the Commission should be reformed, as it has been in the past, so it is fit for the future. It is now for Ministers and Parliament to decide how the Commission’s experience could contribute to effective, efficient and accountable local public services in support of the wider localism objectives.

*January*
The cost of the Commission to audited and inspected bodies, and government, is shown by main activity in Table 1. A more detailed breakdown of the audit income for principal bodies is in Table 2.

The Commission manages its various lines of business in an integrated way, so income and expenditure do not map directly. In particular, fees for audits (other than foundation trusts) were levied under section 7 of the Audit Commission Act 1998. This is subject to schedule 1, paragraph 8 of the Act, which requires the Commission to set fees to cover its full costs. So in addition to the costs of providing the audit, these fees therefore covered the direct expenditure on its corporate functions.

Broadly, fees and grants for inspection, assessment, foundation trust audit and advice and assistance covered the full costs of providing the services.

Information on the 2010–11 forecast and 2011–12 budget is included for comparison. 2010–11 was a transition year; CAA was cancelled and inspection and studies run down during the year. These and other costs reduced as staff left.

The figures in Table 1 also covered the following direct costs:

- Audit regulation £3m £3m £3m
- Studies and research £5m £4m £2m
- Government and stakeholder engagement, policy and analysis £13m £10m £5m
- Governance £2m £1m £1m

The Commission has reduced its support and overhead costs from £48 million in 2009–10 to £23 million in 2011–12.

### Table 1

<table>
<thead>
<tr>
<th>Category</th>
<th>Activity</th>
<th>number of bodies in</th>
<th>forecast</th>
<th>budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit</td>
<td>Local government code audit</td>
<td>457 bodies</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>Grant claim certification</td>
<td>2,856 claims or returns</td>
<td>21</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>NHS code audit</td>
<td>289 bodies</td>
<td>54</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>Payment by results audit</td>
<td>152 bodies</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Foundation Trust audit</td>
<td>55 bodies</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Police and probation code audit</td>
<td>76 bodies</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Small body audit and assurance</td>
<td>9,800 bodies</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Inspection and assessment</td>
<td>Comprehensive Area Assessment</td>
<td>152 area assessments and 402 organisational assessments</td>
<td>30</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>Inspection (housing, police, fire, benefits and other local authority)</td>
<td>67 inspections</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Other</td>
<td>Advice and assistance</td>
<td>Not applicable</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>National Fraud Initiative</td>
<td>1,300 bodies</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Miscellaneous</td>
<td>Not applicable</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>total</td>
<td></td>
<td></td>
<td>213</td>
<td>181</td>
</tr>
</tbody>
</table>
Table 2
AVERAGE FEES PAID—2009–10 FINANCIAL YEAR

<table>
<thead>
<tr>
<th>Type of Body</th>
<th>No of Audits</th>
<th>Total Fees</th>
<th>Average Fee</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Government Code Audit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>London Borough Council</td>
<td>32</td>
<td>12,784</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>Metropolitan District Council</td>
<td>36</td>
<td>12,126</td>
<td>337</td>
<td></td>
</tr>
<tr>
<td>County Council</td>
<td>27</td>
<td>8,648</td>
<td>320</td>
<td></td>
</tr>
<tr>
<td>District Council</td>
<td>201</td>
<td>25,004</td>
<td>124</td>
<td></td>
</tr>
<tr>
<td>Unitary Authority</td>
<td>54</td>
<td>15,294</td>
<td>283</td>
<td></td>
</tr>
<tr>
<td>Fire Civil Defence Authority</td>
<td>30</td>
<td>2,425</td>
<td>81</td>
<td></td>
</tr>
<tr>
<td>Waste Disposal Regulation Authority</td>
<td>6</td>
<td>282</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td>Pension Fund Authorities</td>
<td>2</td>
<td>207</td>
<td>104</td>
<td></td>
</tr>
<tr>
<td>Parish Council</td>
<td>42</td>
<td>658</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>National Parks</td>
<td>8</td>
<td>145</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>Transport Authority</td>
<td>11</td>
<td>846</td>
<td>77</td>
<td></td>
</tr>
<tr>
<td>Local Government Miscellaneous</td>
<td>8</td>
<td>639</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>Pension Fund Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>457</td>
<td>80,000</td>
<td>175</td>
<td>34</td>
</tr>
<tr>
<td>Total Local Government Bodies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Police and Probation Code Audit

| Police Authority                  | 38           | 4,268      | 112         |          |
| Probation                          | 38           | 1,132      | 30          |          |
|                                    |              |            |             |          |
| Total Police and Probation Bodies  | 76           | 5,400      | 71          | 33       |

HS Code Audit

| Acute NHS Trusts                   | 91           | 14,870     | 163         |          |
| PCT                                | 152          | 30,929     | 203         |          |
| Ambulance NHS Trusts               | 10           | 1,445      | 145         |          |
| Mental Health                      | 19           | 2,850      | 150         |          |
| Special Trustees                   | 7            | 105        | 15          |          |
| Strategic Health Authorities       | 10           | 2,040      | 204         |          |
| Special Health Authorities Charities Other |              | 1,761      |             |          |
|                                    | 289          | 54,000     | 187         | 37       |
| Total HS Bodies subject to Code audit |            |            |             |          |

This figure varies by type of body with a range in LG of 33% to 37% with smaller bodies having slightly reduced proportion, and in the NHS 21%–44%. The actual will vary according to auditors’ professional assessment of the risks relating to their VFM conclusion and because of different firms’ approaches to allocating the costs they incur in relation to audit planning, review and reporting.

Written evidence submitted by the Audit Practice of the Audit Commission

1. We noted with interest the evidence given by Prospect to the Committee at its session on the future of audit and inspection on 21 March 2011. In particular, the questions and answers touched on the future prospects of the Audit Commission’s Audit Practice. We think it important that the Committee is given a fuller picture of the preparations the Practice is making to secure a successful future as an all-employee-owned (“mutual”) business in a competitive environment. This memorandum briefly summarises the position and we would be happy to appear before the Committee to expand on these points and answer any questions.

2. The Audit Commission’s Audit Practice comprises 834 audit staff, a 42-strong advisory services team, and 46 support staff (all figures are full-time equivalents). We audit 600 public bodies including councils, fire and rescue authorities, police authorities, NHS trusts and primary care trusts. In addition, we audit 52 foundation trusts which since 2004 have appointed their own auditors outside the Audit Commission appointment regime. We hold 38% of the foundation trust market, making us the largest supplier to this competitive market. We have excellent technical and professional support and provide high quality audits.

3. The management and staff of the Practice wish to continue to be able to offer our distinctive service and ethos to the market once the government’s planned changes to the arrangements for local public audit take
effect. We believe this will provide a genuine choice for local public bodies. To that end, since last August we have been actively preparing for a future in the private sector, preferably as an all-employee-owned business.

4. We have made significant progress in many areas:
   - Restructuring into a single national practice with significantly reduced senior management and support costs;
   - Engaging with staff to develop a vision for an employee-owned business to compete for future audit work;
   - Developing a detailed financial model and business plan for a standalone business;
   - Testing our emerging proposition with existing clients and researching potential new markets;
   - Meeting banks and other potential sources of finance in connection with an employee buyout;
   - Working with the Baxi Partnership (specialists in transfers to employee ownership working with the Cabinet Office) to evaluate the different options for ownership and governance arrangements; and
   - Holding discussions with potential strategic partners to add further strength to our offer.

5. We surveyed our staff in December 2010 and asked them to rank their preferred employment future once the Audit Practice is privatised. 88% selected the employee-owned business as their top preference, 5% selected an existing firm and 7% selected retirement or resignation. Since the abolition announcement in August 2010, staff commitment to delivering high quality audits has remained strong and our staff turnover is no higher than normal.

6. We are ready to share our detailed modelling and business plan with the consultant currently being appointed by DCLG to assess the financial implications of the various options for transferring the Practice to the private sector.

7. Our plans recognise that the skills that have served us well as District Audit for over a century and more recently as an integral part of the Audit Commission will need to be supplemented with a range of commercial skills as we prepare to compete for all our work. This is one of several areas where we see potential advantage in working with a strategic partner to strengthen our distinctive offer.

8. Clearly, the sooner that a decision is taken on how the Practice is to be transferred to the private sector, the better. But we hope this brief memorandum demonstrates that the staff of the Practice are actively preparing for the future, whatever transfer process is adopted. With the single biggest concentration of public audit expertise in the country, we believe we can provide a distinctive choice and have much to offer to our current and potential clients in the future.

areth Da ies
Managing Director, Audit Practice, Audit Commission

Further supplementary written evidence submitted by the Audit Commission

At the oral hearing session held on 14 March 2011, you invited the Audit Commission to give written evidence on:

- Where else in the world do local public bodies appoint their own auditors?
- How much does the Commission save the public purse by taking on the legal liabilities of auditors in their quasi-judicial role?

INTERNATIONAL COMPARISONS

As requested, we have carried out some research into local audit arrangements around the world. This shows a mix of appointment methods for auditors to local public bodies.

In federal countries, such as the United States of America, Canada and Australia, many local services will be provided and funded by a higher level of government body, eg region, state or province, and these higher level bodies will generally be audited by a centrally appointed auditor. In these countries, local authorities appoint their own auditor, but only in relation to expenditure funded through locally raised taxes. Local authorities in Scandinavia, which raise a significant proportion of their funding through local taxes, also appoint their own auditors. However, where authorities’ funding is heavily dependent on central government, as in the UK, Ireland, continental Europe and New Zealand, the auditor is generally appointed centrally.

Our analysis also suggests that, in those countries where local authorities appoint their own auditor, the scope of the audit is generally limited to providing an opinion on the financial statements only, and does not extend to reviewing authorities’ performance or value for money.

It is also interesting to note that in some countries, eg Sweden and Norway, the responsibility for the audit appointment rests with directly elected councillors, who are appointed by the local public bodies to independent audit boards or committees. These councillors then procure audit services from private firms who work directly
for the independent audit board committee, as opposed to the authority itself, and help the audit board committee hold the authority to account.

THE COMMISSION’S INDEMNITY TO AUDITORS

The Commission contracts about 30% by value of all audit appointments to external firms. The terms of those contracts include an indemnity to firms facing litigation arising out of their statutory audit functions.

The indemnity does not protect against negligence—it only applies where the firm has acted reasonably. It is necessary because of the special jurisdiction of auditors, which requires them, from time to time, to take or defend legal proceedings in the course of the audit. Typically, these might be proceedings to determine the legality of a local authority’s actions, or to respond to an appeal by an objector against the auditor’s decision on an objection to the accounts.

If the auditor wins and recovers costs in full from the other party, there is no call on the indemnity. If the auditor loses, there is no basis for charging costs to the audited body as part of the audit fee. But auditors who have acted reasonably should not be disadvantaged financially.

In practice, calls on the indemnity are infrequent. In the last five years it has only been called upon once, and that case is currently subject to appeal. The case concerns the decision of the auditor to reject a wide-ranging objection to the legality of a local authority’s car-parking arrangements. The High Court upheld the auditor’s decision, and ordered the objector to pay £40,000 towards the auditor’s legal costs of £77,370. The Commission has paid the auditor under its indemnity, and will recoup from the costs payable by the objector. Payment against the costs order is currently suspended pending the objector’s appeal to the Court of Appeal.

The costs of the indemnity are borne by all audited bodies through their audit fee. As the costs are low, the impact on fees is negligible. However, the indemnity is worth a lot to the firms, who can be confident that, if they exercise their audit functions reasonably, they would not be exposed to financial risk.

Auditors from the Commission’s in-house audit practice have also faced litigation over the same period. There have been three cases, one in each of 2006, 2007 and 2008, all of which the in-house auditor won. The costs of in-house auditors not recovered from the other side are met by the Commission, and are also passed on to audited bodies in audit fees.

This gives an idea of the frequency of litigation involving auditors across the whole regime. This is relevant as in the future it is intended that the remaining 70% of audits by value will be conducted by the private sector.

It is not possible to quantify the saving to the public purse of the current arrangements. However, the risk of litigation is likely to increase in the absence of a third party such as the Audit Commission providing advice, guidance and support to auditors and indemnifying them against legal costs that may arise. This risk is likely to be passed on in increased fees.

CONCLUSION

Finally, the Select Committee has ended earlier sessions by asking “was it right to abolish the Commission or should it have been reformed?” or by giving the witnesses an opportunity to make some concluding remarks. Our session was interrupted by the division bell, so this opportunity was denied to the Select Committee and the Commission.

Had we been asked the question, our answer would have been clear and unequivocal. We accept that different governments have taken different approaches to the role and nature of inspection during the Commission’s history and our role has been to implement government’s requirements. In terms of audit, we continue to believe that auditors of local bodies should be independently appointed and that a single regulatory body will offer better value for money than if responsibilities are split between different organisations.

We consider that it would be possible to give local bodies more influence over the appointment of their auditor, while retaining the safeguards of independent appointment under the current arrangements, and we will continue to make such proposals to government. We hope that externalising the audits currently undertaken in-house would enable a thriving mutual organisation to develop based on the Audit Practice.

We also believe it is counter intuitive to disband the Commission, with its powers to carry out national value for money studies at a time of change and financial pressure on local bodies. In short, we consider the Commission should be reformed, not abolished.

In terms of finance, the government achieved 70% of its financial objectives by stopping CAA and inspection work. By the end of this financial year, the actual costs of running the Audit Commission—with a retained capacity for regulation, commissioning and value for money studies—will be about £11 million. Our abolition will save these costs, although some will be moved incurred elsewhere as costs of the new regime and transfer to public bodies, regulatory organisations and the firms. There will also be redundancy and other costs to be met as we outlined to the Committee.
Until there is more certainty about the outcome of the Department’s consultation; the legislative timetable; and the costs and benefits of the new regime, the old regime should not be irrevocably abandoned. This would also make managing the transition a less risky proposition and increase staff motivation.

**Written evidence submitted by Prospect**

**INTRODUCTION**

1. Prospect is the professional union for the majority of staff employed in the Audit Commission (the Commission). Currently we represent 1,300 staff, though employment has already declined quite sharply since the announcement of abolition in August 2010. It is worth emphasising that there was no consultation with the Commission or Prospect prior to this announcement, and it is not clear if Ministers were provided with all the relevant facts before decisions were made. Clearly the announcement and ensuing redundancies and uncertainties have since had a dramatic impact on our members.

2. This submission draws on members’ experience and expertise and publicly available documents, including those on the CLG website. The Commission has also made public papers in particular “Issues for Consideration” in September 2010. Use has been made of other websites such as Monitor, the regulator of Foundation Trusts (FT’s), and the NAO. The submission explores how value for money and localism are at the heart of the Commission and are best served by the organisation remaining within the public sector. We consider the next best option to be the creation of a mutual company comprising former staff from the Commission.

**EXECUTIVE SUMMARY**

— The Government’s decision will result in the abolition of a cost effective and uniquely based approach to localised audit as practised by the Commission. We believe this puts at risk an approach that has helped transform local government.

— The proposed abolition targets savings of £50 million. Despite a considerable passage of time since the announcement, there are still no detailed breakdowns of the projected cost savings in the public domain, thus preventing any real discussion or challenge to the Government’s claims. Following earlier announcements and its own ongoing efficiencies, we estimate that the Commission is on target to save £75 million while maintaining its core current functions.

— The proposed abolition provided little or no details on potential liabilities, which we estimate as over £100 million for pensions and up to a further £70 million of redundancies above the current cost of £50 million.

— We believe that the changes to the current independent appointment of auditors will compromise the current high standards of scrutiny and subsequent performance in local government.

— We recommend that the Commission should continue as a public sector audit body. This is not an argument against well-founded change, with which Prospect would wish to engage constructively. The next best option would be the creation of a mutual, which would provide local government bodies with a genuine choice in a market that is likely to be dominated by only a few auditors.

**BACKGROUND**

3. For 28 years the Commission has operated as an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone, across local government, health, housing, community safety and fire and rescue services. It is a widely held view that the Commission has had a positive impact. Even in the context of advice on abolition CLG officials have acknowledged that “the Commission made its mark—quality of local government has been transformed.” That said, on 13 August the Minister of State for CLG, announced “My aim is to replace the current centralised audit systems, managed by the Commission, with new decentralised audit, to provide genuine support for local democratic accountability, and save tax payers some £50 million per year.” Yet, from answers to written Parliamentary Questions and from a face-to-face meeting with the Parliamentary Under Secretary subsequent to the abolition announcement, we have yet to obtain any evidence that this decision was based on costings. This suggests that this is a political rather than a cost saving measure.

**VALUE FOR MONEY**

4. One of the main arguments put forward for the abolition of the Commission was that “the current arrangements are needlessly costly”. Savings of £50 million were estimated from the abolition of “superfluous activities in the central Commission” and as a result of competition for audits. The failure of the Government to provide detailed information in respect of cost savings makes informed debate hugely problematic. However, as shown in this paper, savings over and above the specified £50 million could be made without recourse to a risky abolition process.
5. The underlying papers on the CLG website do not provide a breakdown of the £50 million savings figure, but do refer to the cost of the corporate and central directorates as £52.1 million. Correspondence dated 18 June from Paul Rowsell, Deputy Director for Local Democracy at CLG, notes “significant savings can be expected from the abolition of the Commission’s corporate core and centralised functions”. We are not convinced by this—although some work will be discontinued work, as discussed below, there are a number of functions and costs that will continue. Further, CLG papers acknowledge that “costs are already being cut through the internal efficiency programme”. We estimate that in salaries alone the Commission is looking to save £25 million from central and support costs.

6. Papers supporting the Minister’s interview with the Daily Telegraph on 13 August state, “Private firms are prepared to work at fees lower than those charged by the Commission to the audited bodies.” However, an examination of the official papers does not provide any supporting evidence or source for this statement. A paper entitled “Armchair Auditor Draft Narrative” on the CLG website, says “Genuine competition in the public audit market should see fee rates tumble by around a third . estimated at saving at least £65 million annually.” However, the source of this estimate is not given.

7. Official papers do identify issues around the level of existing fees. For example, correspondence dated 29 June looks to the attraction of “a competitive environment that will drive down the inflated audit fees that the councils have suffered in recent years.” Officials quote an increase in fees to local government from £80 million in 1997 to £150 million in 2010. Yet no contextual or comparative information is provided. In fact since 2002–03 the turnover of the Commission has remained level despite a period of increased audit requirements in part due to the high profile failure of private sector companies such as ENRON. This is indicative of efficiencies being achieved by the Commission.

8. More broadly, following growth of the Commission from 1997 expenditure has levelled in recent years and is now below expenditure growth in related areas of local government. In addition, the cost of auditing FTSE 100 companies has risen by 121%, from £238 million to £527 million.

9. The performance of the audit market for FT’s is also instructive. The first FT’s were established in 2004 under a new regulatory regime including competition amongst auditors, overseen by Monitor. The average fee of the first 32 FT’s has fallen from £81k in 2005–06 to £75k in 2009–10, but a further analysis of the figures indicates:

- Other audit costs have risen from £9k to £32k so that the full cost charged by auditors has increased from £90k to £106k.
- The Commission auditors may have contributed significantly to holding fees down, as in 2009–10 the Commission average fee at the earliest Trusts was £61k, compared to £78k from private firms.

10. The experience of the FT’s indicates that the hoped for “one third” cut in fees is not likely to materialise. Moreover, papers on the Commission website state that “Baker Tilly and Mazars were unsuccessful in the latest procurement exercise on grounds of price.” This would indicate that for some private sector firms the audit fees are already considered low.

11. The Commission also suggests, “Our experience has been that prices fall as the guaranteed volume of work increases: in other words, there is a volume discount. Under the proposed decentralised system, this benefit will be lost, as audit suppliers could not be assured of sufficient work overall to be in a position to bid as competitively as they do in the present system. This is likely to impact on prices.”

12. Prior to the announcements of its abolition, the Commission was looking to making significant savings. Our own estimate indicates that cost savings of over £75 million are likely in relation to the end of the work on Comprehensive Area Assessments (CAA), Inspections, a reorganisation of central services and some reduction in work by auditors. This comprises savings to clients of £40 million, to central government of £25 million and internal savings of £10 million. In its final year of operation the Commission, while maintaining its audit function as well as its regulatory role, is likely to be about half the size it was in 2007–08.

13. On 18 June Paul Rowsell referred to “the potential for receipts from the privatisation break up of the Commission’s audit practice.” Officials stated in an e-mail of 28 July, “we are recommending a relatively low key announcement to enable wider engagement and stimulate market interest.” A range of options is under consideration including: a trade sale; management buy-out; or mutualisation or some other form of employee ownership.

14. However, it is not clear what is being valued and then sold. There are no obvious tangible assets. A value could be placed on the intangible customer relationship but the future cash flows are not certain as, in
contrast to the current structure, there are no guaranteed future income streams. A value could be placed on
the expertise of staff, but this would need to reflect potential liabilities such as redundancy terms.

15. We believe there is a risk that existing major players in the audit market will monopolise the current
Commission audits to the exclusion of new players in the public audit market. These would be the same
private sector companies whose ethics were recently attacked by the Financial Reporting Council’s Professional
Oversight Board. It was their incomplete attention to detail, or some would say negligence, that allowed the
Banks to precipitate the recent financial crisis and companies like Enron to conduct their business in a far from
appropriate manner. Prospect does not believe that this level of deregulation, particularly in respect of the
public finances, is appropriate. Evidence from previous privatisation of core business functions such as IT and R
&D is that once the State has lost the ability to be an intelligent customer, then the private sector does not
deliver good quality, affordable services. Notable examples include MOD’s air refueling fleet and Nimrod
programme and HMRC’s computer system.

COST OF ABOLITION OF THE AUDIT COMMISSION

16. An examination of the official papers on the CLG website covering the abolition of the Commission
reveals little information on the costs involved. The two main areas of cost relate to redundancies and retirement
pensions, although there will be costs of the new regulatory regime and penalties for early termination of
property leases.

REDUNDANCY

17. The abolition of the Commission will entail significant redundancy costs. One of the very few references
to this in CLG papers refers to the Commission “funding redundancies from its own reserve.” These were
£29.1 million at 31 March 2010. The Commission’s 2009–10 Annual Report includes redundancies averaging
£70,000 for the staff affected. Using this figure, the cost of redundancies for the 1990 staff employed at 31
March 2010 can be calculated as follows:

- Pre-abolition announcement on end of the CAA work. Estimated 300 staff or £21 million.
- Reduction of central staff estimated at 300 or £21 million.
- Scaling down of auditors and support staff estimated at 300 or £21 million.
- Potential reduction of the remaining audit business would result in further redundancy costs of at
  least £60 million.

18. This amounts to a total liability of over £120 million, significantly higher than the Commission’s reserves
of £29.1 million. Clearly redundancy costs would be reduced as a result of staff turnover or transfers, if
feasible, to private audit firms. However, given the redundancy liabilities of transferring staff, firms may require
financial guarantees, underwritten by the taxpayer and forming an ongoing liability for the Government.

PENSIONS

19. Official papers reveal what appears to be an initial consideration of pension fund liability. After reflecting
on the figures, an e-mail concludes “What all this shows is that this is an area of considerable risk.” The key
figures for 31 March 2010 were:

- Existing net pension liability of £106 million.
- Solvency basis method of valuing the pension liabilities (essentially the cost of buying out the
  benefits) with a suitable insurer at £357 million.

20. In the light of this “considerable risk” Prospect is very concerned that nearly five months after the
abolition announcement the Government has made no concrete proposals in respect of pensions. It is difficult
to envisage how the cost of, at least £106 million—and in Prospect’s view likely to be much more—will not
end up being passed on to the taxpayer as an ongoing liability.

COST OF ALTERNATIVE REGULATORY BODIES

21. Discussions have identified the need for the continuation of many of the Commission’s current functions
following abolition, such as the regulatory role. In September 2010 the Commission also stressed the need to
“invest significant resources in providing technical guidance and advice, and support to its appointed auditors”.
The Commission identified the total cost of the regulating regime as £3.1 million. Adding the cost of technical
support, total regulatory and support costs is estimated at £8 million, or £9k for each principal audit.

22. The cost of regulation can be much higher as illustrated by the £15.9 million cost of Monitor, equivalent
to £123k for each of the 129 FT’s and equivalent to almost twice the cost of the basic audit fee. In the next
few years the cost effective Commission regulatory regime will be replaced by:

- NAO overseeing local government.
- Monitor overseeing NHS Foundation Trusts.
- NHS Commissioning Board for other NHS bodies.
— Fire and emergency not known.
— Police not known.
— Housing not known.

23. It is also worth emphasising that the regulatory regime operated by the Commission has, by widespread consent, contributed to the improvement in local government performance. Change will put this at risk. Research quoted in the Government Memorandum of Evidence to the Inquiry by The House of Lords Economic Affairs Committee in September 2010, found a number of failings in the private sector. The report concludes that for many listed companies there is “much room for improvement in their narrative reporting as required by the Companies Act.”

RESEARCH AND OTHER FUNCTIONS

24. The abolition announcement included the statement that “The Commission’s research activities will stop, ending duplication with others and strengthening the NAO’s role in this area. Responsibility for overseeing the current anti-fraud data matching functions will be transferred to the NAO, or to other bodies currently operating data matching systems.” Therefore the cost of these functions will continue, albeit at a reduced level. Yet, an important element of the Commission’s research and anti-fraud work is the link it has with local audit teams. It is not clear how the London based NAO will continue to reflect this local perspective.

LOCALISM

25. It is worth emphasising that the Government has trumpeted the principle of “total place”—governance without borders. Initiatives like the creation of a single Chief Executive for the Herefordshire local authority and Primary Care Trust have been welcomed. Yet the removal of a single agency that is already auditing across departmental borders is counter to this direction of travel.

PERCEIVED AUDIT COMMISSION FOCUS

26. The abolition of the Commission has been justified on the basis of a need to foster localism. The Government’s press notice of 14 August stated, “Local people will now be the audience for assurances that their council is spending money wisely, that they are well governed, their council is financially robust, achieving value for money and providing accurate information and data.” The “Project Armchair draft narrative”, reflects a view that “performance managers in the audited bodies dance to the tune of the auditors and inspectors not citizens and communities. The Commission today fosters compliance not improvement—its part of the problem, not the solution.”

ACTUAL AUDIT COMMISSION FOCUS

27. These views are not justified by evidence. In fact, the Commission auditors follow an approach that is grounded in localism. Auditors account for their work plans and output to locally elected councillors; or in the NHS to non-executive directors, usually through regular presentations to the local Audit Committee. At most principal bodies there will be separate presentations of the:

— The proposed audit plan for the year;
— The results of the work on the financial statements; and
— The results of all aspects of the work in the Annual Audit Letter.

28. The public have rights with regard to audit processes and local auditors respond to these as part of their work, including meeting the public as required. Private firms under also follow this approach under the current regulatory arrangements. However, unlike private firms and the NAO, many Commission staff work at permanent sites in local government offices. This provides auditors with a local focus and easy access to councillors, council officials and members of the public. In London, for example, Commission auditors are based in the council offices at 19 out of the 20 Boroughs they audit.

29. It has been proposed that work should be refocused to ensure the “council is financially robust, achieving value for money and providing accurate information and data”. However, this is currently a basic function of the local auditors. The results of this work are specifically reported each year in the auditors Annual Audit Letters. The critical focus on the high profile inspection and CAA work undertaken by the Commission has obscured the underlying approach to the local audit work that has been in place for over 150 years.

CHOICE OF AUDITORS AND COST

30. Under the current system the Commission appoints auditors from its own audit practice and private firms, following consultation with local bodies. The papers published on the CLG website indicate the end of this approach in order to create “genuine local choice to be exercised by councils and other bodies about their auditors.” (Paul Rowsell 18 June). In reality however, choice will be fettered as there is only a limited range of auditors that can undertake the work.
31. A number of concerns have been expressed over the lack of choice of auditors and the dominance of the market generally by a few private firms. This is reflected in the submission and discussions relating to the House of Lords Economic Affairs Committee inquiry “Auditors: Market concentration and their role,” which highlights that four firms undertake the audits of 99% of FTSE 100 companies and 95% of FTSE 350 companies. The development of FT’s also confirms that choice is limited. In 2009–10, excluding the Commissions auditors, just two firms, PWC and KPMG, undertook almost 75% of the remaining audits.

32. Choice also comes at a cost. The Commission in its paper “Issues for Consideration” says, “In a free market, we believe there is a risk that some local authorities may find it hard to attract an auditor with the necessary skills and experience, at a reasonable price. the current benefits of pooling auditors’ costs will be lost and councils in remote geographical locations will have to meet the economic cost of the audit.”

33. It also has associated risks. Commission papers reveal a range of problems encountered during an earlier procurement exercise: “In 2000–01 we offered nearly 1,400 parishes the opportunity to appoint their own auditors. Only 300 expressed an interest in doing so and only just over 80 proceeded to the final stage of carrying out their own tendering exercise. Many of those not proceeding said that the costs of tendering were prohibitive. Our review showed that all bar a handful of the 24 firms of auditors selected by parish councils failed to recognise conflicts of interest and to understand local government law and the special accountabilities associated with public funds. The quality of audits was generally poor.”

34. The CLG papers do not provide any cost estimate of local procurement for audit fees, but across the thousands of bodies for which the Commission currently appoints auditors, this is likely to run into millions of pounds.

35. It is also worth emphasising that the Government does not seem entirely convinced of its own arguments: despite the emphasis on localism, a CLG paper on 5 August stated “If necessary, the Government may retain a power to set fee levels.” Such central government interference clearly runs contrary to the move to localism and also questions the independence of any new regulatory regime before it is established.

OTHER ISSUES

36. The abolition of the Commission does raise some other issues, as outlined below:

INDEPENDENT APPOINTMENTS AND NON-AUDIT WORK

37. It is commonly held that the most effective way of ensuring the independence of auditors is for them to be appointed wholly independently of the audited body. The current system, in which the Commission appoints auditors on behalf of the local and national taxpayer, ensures that those responsible and accountable for the stewardship and use of public money are not involved in appointing those responsible for scrutinising how it is spent. This duty to appoint external auditors will be transferred to local public bodies themselves with freedom to appoint auditors.

38. Papers on the CLG website refer to the “perceived accountability gap” arising from abolition of the Commission, but provide no comprehensive assurance that this will be satisfactorily resolved. The apparently limited CLG concern is not consistent with debates at the political and professional level. At the root of a number of concerns around independence has been the view that auditors compromise in order to maintain or win lucrative non-audit related work. This is currently under investigation by the House of Lords Economic Affairs Committee and also the EU. In the USA, the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) barred public accounting firms from performing non-audit services for audit clients.

39. Concerns surrounding the independence of consultancy work added to pressures in FT’s where, from 2008–09, the cost of consultancy work has to be disclosed. The figures disclosed in 2009–10 for the 129 FT’s were as follows:

- Statutory audit fee—£8.7 million.
- Other audit costs—£6.2 million.
- Consultancy costs—£141.6 million.

40. Non-audit firms undertake much of the consultancy work but private sector auditors’ interest in audit work is stimulated by access to the lucrative consultancy market. At £1.1 million for each FT taxpayers are paying considerably more for advice than statutory audit work. The Commission bars its own auditors undertaking consultancy work; an approach that should apply in the future to all firms at bodies they also audit.

AUDIT COMMISSION ALLOCATION OF AUDIT WORK

41. The independence of the Commission has been questioned in CLG papers, which argue “that the Commission ensures independence of external challenge—yet it appoints mainly its own auditors (70% of the time—only 30% is from private practice).” The main reason for this is that traditionally the in-house auditors have been more cost-effective. In addition, this facilitates economies of scale, which private firms also benefit from in relation to their business as whole. It should be noted that other public sector accounting bodies in the
UK such as the NAO, Audit Scotland and Welsh Audit Office follow a similar division of around a 70% share for in-house auditing and a 30% share for private firms.

January

**Written evidence submitted by Age**

Age UK is the new force combining Age Concern and Help the Aged. We are a national charity and social enterprise working to transform later life in the UK and overseas. Our vision is of a world in which older people flourish. We aim to improve later life for everyone through our information and advice, services, products, training, research and campaigning.

Age UK welcomes the opportunity to input into the inquiry into the audit and inspection of local authorities by the Communities and Local Government Committee.

**SUMMARY**

Age UK believes that the external, independent audit of local authority expenditure and performance is essential to maintain confidence in public spending and the working of public sector bodies.

We are concerned that without overview from a central independent body, the standards and independence of public audit may be compromised.

We believe there needs to be continued oversight and inspection of the performance of services commissioned and delivered by local authorities. To ensure transparency and accountability, a form of performance management system is essential, although this should be more locally, rather than nationally, determined. Some level of national oversight will still be needed to ensure local agencies meet public duties set at national, European and international levels. Assessment of performance management should involve a wide group of stakeholders including local older residents and results should be publicly reported, in print form as well as online.

We believe that comparative nationwide studies and reports are of benefit when assessing the performance of local authorities and would hope that funding will continue to be made available for independent organisations to carry these out.

In March 2010, Age UK commissioned research into the value and impact of the previous performance management framework on older people. This research has produced valuable findings which offer lessons to be learnt from the previous system and we hope these will be of use when considering future arrangements.

We include a summary of our findings in the oversight and inspection of local authority performance section of this submission.

**AUDIT OF LOCAL AUTHORITY EXPENDITURE**

The Government is keen to develop a culture of transparency to enable local residents to hold their councils directly to account for the decisions they make.

As outlined in the guide to the Decentralisation and Localism Bill, published in December 2010, a key element of this move to transparency is the publication of items of expenditure over £500 and of “raw data”. The Government believes this will enable “anyone to analyse and visualise the information, spot trends and make connections that would otherwise go unseen”.

Age UK supports any improvement in the provision of information that enables local residents to make judgements on the services they receive from their local authority. However, independent audit and inspection is a professional discipline essential for maintaining public confidence in public spending and the delivery of public services, and should be continued alongside any new arrangements for increasing transparency of public information.

The analysis of raw data requires specific skills, time and resources which may not be available to individual local residents in the way that Government assumes. Our understanding is that the data will be published online. Recent statistics show that 60% of people aged 65 have never used the internet. Limiting the availability of data to online would therefore immediately exclude two thirds of older residents, many of whom are significant users of local public services. This would clearly be unacceptable.

We strongly recommend that future arrangements place a duty on local authorities to publish data in a format, both in print and online, that is easily understood and useable by local residents.

For information that is presented online, lessons should be learnt from the One Place website which published the results of the Comprehensive Area Assessment. A focus group of older internet users commissioned by

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35 ONS Internet Access Households and Individuals 2010.
Age UK in December 2009 found that the data on the One Place website was easy to understand and concluded that they would be happy to use this website as an ongoing source of information.

Age UK supports a number of the points made by the Audit Commission in their document “The future of local audit: issues for consideration”\(^{36}\). In particular we would echo the points made about:

— the need to safeguard the independence of auditors;
— the costs and availability of auditors to local authorities under a free market model;
— the need for a regulator of any new audit regime;
— the need to monitor and regulate the performance of auditors;
— the importance of public reporting; and
— the wider scope of public audit.

**Oversight and Inspection of Local Authority Performance**

Age UK believes that in order for local residents to effectively measure and monitor delivery and efficiency of local public services, local authorities need to have a performance management framework in place to which they are locally accountable. We agree with the Government that this should be “outcomes” rather than “process” driven. However, we do not believe that the publication of data or results from the ballot box alone are sufficient measures of the performance of a local authority.

We agree with the principles of localism, that allow for councils to develop local solutions in response to local needs, but we will want to see clear and transparent local frameworks in place which demonstrate what priorities have been set and what measures are being taken to improve services.

Some level of national oversight will continue to be needed to ensure public duties are being met. The Government has published a draft “single list” of central government data requirements from local government. It is not clear whether these reporting requirements will be separate from or form part of any future local performance management arrangements. We will be responding separately to the consultation on this list to ensure data relevant to services affecting older people is being reported appropriately.

Further details on Age UK’s views on national and local accountability have already been submitted to the Committee as part of the Inquiry on the Localism Bill\(^{37}\).

In March 2010 Age UK commissioned research into “The value and impact of the performance management framework on older people” to identify what lessons could be learned from the previous performance management system for local authorities.

In summary, the findings of our research showed that:

— The previous system of Local Strategic Partnerships and Local Area Agreements resulted in improved partnership working between local agencies. Respondent felt this needed to be built on.
— High level leadership and early engagement with political leaders is essential to the success of performance management and partnership working arrangements.
— LSPs believe a more outcome focused approach with local leadership and local autonomy will lead to improved services for older people.
— The previous system was considered overly bureaucratic and too prescriptive to allow creativity and innovation in finding local solutions to local problems.
— All plans and strategies of partner agencies in a local area must be aligned to ensure consistency of approach.
— Timescales for any central government reporting requirements should fit with local integrated planning processes and not delay them.
— Although older people’s issues are cross cutting they are often restricted to discussion at a sub group that has a health and social care focus.
— The limitations of the availability of existing data indicators should not skew priority setting.
— Much of the existing data available to local authorities is relevant to older people if broken down by age.
— The methodology of new data collection methods must be robust.
— Decision-making and monitoring structures should involve community and voluntary sector representatives.
— The time and resources required for monitoring should not be excessive.

The key levers necessary for improved outcomes for older people, identified by the research are:

— A commitment from the council’s cabinet to involve older people in a meaningful way in setting priorities and making decisions about local services.

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\(^{37}\) Age UK Response to Communities and Local Government Committee Localism Inquiry, Oct 2010
— The views of older people used to inform the planning of services across all parts of the council not just health and social care.
— Investment in the infrastructure and support required to develop effective and independent older people’s forums.
— The development of strong networks of older people willing to share their views and experience.
— Older people being represented at all forums where decisions are made on issues of importance to them.
— The use of outcome focused performance indicators such as those used in Outcome Based Accountability (OBA).
— Better breakdown of available data by age to demonstrate trends across all services.

Our research highlighted some encouraging examples of where older citizens are having a voice in shaping local decision making. However, this is not always the case. Future arrangements should put mechanisms in place for the meaningful engagement and involvement of local older people in planning and priority setting.

Overall our research showed that while the previous performance management system undoubtedly had flaws, there are valuable lessons to be learned which must be applied to any future arrangements. We recommend that local authorities are encouraged to retain the best from the previous system when developing their own local frameworks.

Although our research has not yet been published, we would be happy to share further detail of our findings with the Committee.

VALUE FOR MONEY STUDIES

We do not have comments to make specifically on VFM studies.

However, we would like to comment on studies or reports more generally.

The Audit Commission has been responsible for producing a range of excellent reports in recent years and this function will be greatly missed. In particular, two reports have been pivotal in the analysis of local authority performance with regard to services for older people:


Age UK believes it is essential that the Government continues to commission and fund comparative nationwide studies which can identify and address emerging issues and raise awareness of good and bad practice.

In order to ensure meaningful comparisons can be made, nationwide surveys and national data collection methods will need to continue to be supported and the results made available to a wide group of stakeholders.

January

Written evidence submitted by the Women’s Resource Centre

EXECUTIVE SUMMARY

— The Women’s Resource Centre (WRC) believes that the introduction of a decentralised audit regime will negatively impact on gender equality and service provision to vulnerable women at a local level.
— WRC believes that centralised audit and inspection is vital to address inefficiencies featured in local decision making and promote equality to ensure that women receive the services they need.
— The Women’s Resource Centre wishes to provide oral evidence to the Select Committee and hopes that the Committee will consider the impact of changes to auditing and inspection from an equalities perspective.

BACKGROUND INFORMATION

The Women’s Resource Centre (WRC) is a charity which supports women’s organisations to be more effective and sustainable. We provide training, information, resources and one-to-one support on a range of organisational development issues. We also lobby decision takers on behalf of the women’s not-for-profit sector for improved representation and funding. Our members work in a wide range of fields including health, violence against women, employment, education, rights and equality, the criminal justice system and the environment. They deliver services to and campaign on behalf of some of the most marginalised communities of women. There are over ten thousand people working or volunteering for our members who support almost half a million individuals each year.
Consultation Response

1. As central government devolves greater power to local authorities the transfer of responsibility must be paired with accountability. It is essential that an independent centralised regulatory body inspects the performance of local authorities and holds them to account.

2. The Women’s Resource Centre (WRC) is extremely concerned about the government’s decision to disband the Audit Commission. We believe that the introduction of a decentralised audit regime will negatively impact on gender equality and service provision to vulnerable women at a local level.

3. The WRC’s key area of concern regards the abolition of Comprehensive Area Assessments. Under the Comprehensive Area Assessment, local authorities were evaluated on their efforts to tackle inequality and focus on the needs of disadvantaged groups, including women. Partners would be assessed on how well they understood the nature and extent of inequality within their communities and how effectively they were working to reduce or eliminate discrimination.

4. By abolishing Comprehensive Area Assessments a crucial interagency focus on tackling inequality has been lost. The joined-up approach of the Comprehensive Area Assessment offered enhanced intelligence on how well local services worked together to achieve improvement and progress towards long-term goals. This loss has occurred at a time when comprehensive inspection of local authorities in relation to inequality is ever more crucial.

5. As funding contracts in the economic downturn local councils are less likely to fund specialist services which meet the diverse needs of their communities. Many local authorities do not understand the importance of gender inequality and cannot be relied upon to fund key women’s services. Already in the infancy of public sector spending cuts, some local authorities have cut Domestic Coordinator posts due to the need to create efficiency savings.

6. Comprehensive Area Assessments encouraged authorities to adopt a broader view of “value for money” and commission services that meet local needs. The assessments focused on both effective community engagement and understanding of the needs of vulnerable and marginalised groups. Most importantly, the assessment framework offered a means for enforcing the Duty to Involve and provided the sole mechanism through which local women’s organisations could hold local authorities to account. The assessment’s measurement of the representation of marginalised groups in local decision making, empowered women’s organisations to challenge the representation of women and women’s issues in local leadership.

7. Without comprehensive centralised audit and inspection, it is less likely that local authorities will actively address gender inequality in their local communities. WRC research shows that many local authorities do not deem gender equality to be a priority and fail to meet their legal obligations under the Gender Equality Duty and Duty to Involve.

8. Under the Government’s decentralisation programme local government will be given greater responsibility for promoting community involvement in decisions; however it lacks a strong reputation on its engagement of diverse groups in local decision making. Women’s organisations represent just 2% of VCS representatives on Local Strategic Partnerships and repeatedly report experiencing difficulties with public bodies in participating and influencing locally.

9. Due to a myth of gender equality authorities often pursue gender neutral policies or misinterpret gender equality to mean treating men and women the same. These problems contribute to the under valuation of the importance of women-only services and increases authorities reluctance to engage with women’s voluntary and community organisations. This in turn limits local authorities’ capacity to ensure that the needs of the women within their communities are effectively met.

10. Women’s organisations are often excluded from commissioning processes as they wish to enlist a generic provider to save money. A reduction of public funding may increase cost consciousness and encourage councils to disregard the social value of services. There is an active risk that equalities will be marginalised in the recession as councils seek to focus on financial “priorities”. It may be misinterpreted as an issue that is “frivolous” at a time when councils are seeking financial survival, rather than viewed as a vital way to effectively meet the diverse needs of communities.

11. Centralised audit and inspection provides an essential opportunity to address inefficiencies featured in local decision making and promote equality to ensure that women receive the services they need. It provides a safeguard for the protection of services that benefit the majority of the population and transcends the politics of local decision making. Failure to have a comprehensive approach to audit and inspection may mean that the needs of minority groups, such as disabled women, many be overlooked. It was planned that Comprehensive Area Assessments were to include monitoring of Equalities Duties, however without that mechanism national government will not have that monitoring data.

Urban Forum, Oxfam, Women’s Resource Centre, 2007, Where are the women in LSPs?
http: www.wrc.org.uk includes documents cm_docs 2008 w womenlsp.pdf

WRC, 2010, Power Prejudice: Combating gender inequality through women’s organisations
http: www.wrc.org.uk includes documents cm_docs 2010 w wrc_power_and_prejudice_final.pdf
12. National regulation of local authority performance is ever more important due to proposed changes to the Public Sector Duties contained within the Equality Act 2010. Under the proposed measures public bodies will no longer have to produce a Gender Equality Scheme outlining the actions they have taken to promote gender equality. Local authorities will be permitted to set a minimum of one equality objective focusing on the protected characteristic of their choice, for example race. Under this new system it is less likely that gender will be prioritised; therefore Government will have limited evidence of how local authorities are meeting local women’s needs.

13. The Government’s plan to refocus the audit of councils on helping local people hold local bodies to account is an insufficient mechanism to ensure good public authority performance. Greater transparency and local democratic accountability should compliment rather than replace a centralised regulatory system. Plans to empower local communities may in practice perpetuate existing local power structures and replicate the under-representation of women in local decision making. For example, women predominantly assume caring responsibilities within families and therefore often have limited ability to engage in local politics.

14. Increased local democratic accountability could lead to inconsistency in regulatory oversight, as public challenges depend on the capacity, inclination and education of local people. Whilst authorities may publish data, citizens may not be interested in accessing information or fully aware of the context or implications of the information made available. For example, civil servants acquire expertise in policy areas over the course of their careers, the general public may lack the background and experience required to comprehend the implications of local government actions.

15. Where women seek to mount legal challenges against local authority decisions; their access to justice may now be restricted due to planned reductions to legal aid. Under government proposals women’s eligibility and access to funding will be dramatically reduced.

Written evidence submitted by the Taxpayers Alliance

Summary

— The TaxPayers’ Alliance welcomes the abolition of the Audit Commission. It has placed an unnecessary and costly burden on local authorities and stifles competition.
— The auditing of local authority accounts should be transparently tendered out to the private sector, to help drive down costs and to ensure independent decision making that is accountable to taxpayers.
— There should be no body or organisation formed to carry out compliance functions, as this was perhaps the most egregious and costly of the Audit Commission’s activities.
— The TaxPayers’ Alliance believes that full and useful transparency will be a very powerful tool to hold local politicians and council staff to account, to run alongside traditional financial auditing.

The Audit Commission

— The Audit Commission was an instrument of central government, finding new and increasingly bureaucratic ways of controlling local councils. The Audit Commission has incrementally been handed—and lobbied for—greater powers, which have seen it stifle innovation at a local level in favour of meeting centrally prescribed targets. The TaxPayers’ Alliance welcomes its abolition.
— Centrally set targets do nothing to improve local services. Systems like star-ratings—once described as “disrespectful and utterly perverse” by Vince Cable—graded local authorities with stars, which were boasted about by local authorities but roundly ignored by everyone else. They made authorities compete in the wrong way; not by benchmarking service quality and efficiency, but so as not to be graded lower than their neighbouring authorities. Consequently, these targets—stars, flags or otherwise—do nothing to improve services, they merely undermine their performance. Councils became obsessed with compliance and fearful of poor Audit Commission reports. The Audit Commission should have stuck to its primary job and it clearly strayed too far outside of its remit.
— The cost of the Audit commission in 2009–10 was £220.3 million. Scrapping this body will obviously not save all of this money, as councils will still have to pay for the cost of auditing. But significant savings will be realised as the Audit Commission costs over £50 million to administer and staff.

40 http://www.guardian.co.uk politics 2010 aug 13 audit-commission-to-be-scrapped
However, there should be additional savings too. For example, the cost of complying with Comprehensive Area Assessments (CAA's) is estimated to be in excess of £300,000 for some councils. Local authorities were under great pressure to meet the targets set so felt that they had no choice in paying.41

The TaxPayers' Alliance welcomes the decisions to scrap Comprehensive Area Assessments and to abolish the Audit Commission. We believe the Department for Communities and Local Government have worked quickly to strip out bureaucracy and give councils more freedom. We feel that councils should have more revenue raising powers but some important steps have been taken to give local people a greater say on how their local services are run.42

To that end, it is crucial that the Audit Commission is not simply replaced by another bureaucratic quango.

The TPA agrees that auditing should be tendered out to the private sector. This has the clear benefit of opening up the service to competition. Local authorities have had auditing enforced on them by one organisation; if they have choice then this will help drive down costs. For example, the costs of auditing Birmingham Council’s accounts in 2009–10 was £1.2 million, a council with an income of £2.5 billion, compared to the £0.6 million spent by the entire HMV group on auditing fees in 2009–10, an organisation which has private revenues of over £2 billion. While admittedly this is not a like-for-like comparison, the difference between the two costs cannot be ignored. The doubling of the costs makes a strong case for seeking private firms to audit local authority accounts.

There has been concern that private auditors would not necessarily be independent from Government. This apprehension is warranted, as cosy relationships between public bodies and private companies can and do happen. To ensure the independence of the auditors and to continue the agenda of transparent government, it would be vital that the tender process of selecting an auditing firm was an open and public process.

The TPA strongly believes that fully transparent government—though currently in its infancy—will in time provide local taxpayers with genuine tools to hold elected politicians and council staff accountable. Centrally set targets do not work for different councils with residents that require completely different services over and above core provisions. There should absolutely be no new body or organisation that carries out a compliance function on behalf of the Government.

The centralised nature of British Politics has bred and assiduously maintained a culture of “Government knows best”. One major failing of this is that local people are being told how their services should be run by politicians who do not have a true understanding of issues in their local area. The Audit Commission was part of this and subsequently did absolutely nothing to nurture innovation at a local level; it merely fostered compliance and local authorities suffered as a result.

To create a more efficient local government structure in the UK, local authorities must feel that they are accountable to the people who both elect them and pay their salaries. This is only possible if local authorities are given more independence and freedom from centralised and standardised requirements. The system under the Audit Commission was that local authorities were not met with substantial repercussions for failure. The audit commission can grade a council, however this is meaningless to local residents, and priorities will naturally be different across council boundaries.

Much of what affects residents should be decided at a local council level. Decentralising the balance of power to local authorities makes for cheaper and more efficient governance.45

The Audit Commission worked in an era of obfuscation and opaque governance. This meant that they have been the sole arbiters of council spending. Taxpayers’ deserved—and continue to deserve—much better.
olutions
— The abolition of the Audit Commission complements the measures already taken to increase transparency throughout local government. The decision to publish all spending over £500 allows local residents access to scrutinise the spending of their councils and effectively hold them to account. This can be done in tandem with examination of local authority annual statement of accounts which, while more detailed in recent years, still need to be more comprehensive and accessible.
— One major stipulation that the TPA would make is that the publication of any information must be in a practical and serviceable format, user friendly to the local residents and easily available online. The publication of data will lead to the creation of armies of armchair auditors, which ultimately comes at very little cost to the taxpayer.
— The oversight and inspection of local authority performance is not a role that requires heavy spending from central or local government. Civil society is the most effective and proven guardian to watch over council spending and performance. Those who pay for and use the services will be more concerned about how their money is spent and how their services perform than a public sector body. Through empowering local people to challenge underperformance, councils can establish a self reviewing system which can fill the void left by the audit commission at a much reduced cost.

January

Written evidence submitted by APSE

Summary Remarks

A more flexible performance framework should allow for the reporting to local tax payers of a mixture of easily understandable, and identifiable, performance outcomes including a mixture of cost and productivity, quality and customer satisfaction indicators. Local flexibility could be integrated into such an approach by councillors choosing which indicators best match local priorities but to allow comparisons to other councils through a national “guideline set” of the types of indicators that ought to be available to the public. For example a council elected on a “green agenda” could choose to report its performance on the amount of waste that it has converted into useable green energy or a council committed to public health outcomes could choose to report on participation levels within local leisure centres.

Such an approach would reflect the Coalition Government’s intention to decentralise decision making but also to increase local accountability. Unlike previous performance frameworks this would direct attention towards meaningful outcomes for local people. However, such a framework would critically allow an early warning system to remain in place should the rare need to intervene in a local authority become necessary. A good performance indicator set, locally managed, controlled and reported, of itself would help to demonstrate that the local council is managing resources effectively.

This submission sets out how the UK’s largest local government voluntary benchmarking service, operated by a not-for-profit local government body, is able to provide, as part of a new performance framework, a robust transparent and easily understandable set of performance indicators which are adaptable to local circumstances and local priorities. Local authorities have developed comprehensive systems over the past 12 years which should, APSE believes, be utilised as this will ultimately lead to a reduction in duplication and avoid unnecessary and costly new burdens on local councils.

1. About A

1.1 APSE is the Association for Public Service Excellence and is a not for profit local government body working with over 300 councils throughout the UK. The Association has existed for over 25 years and is a highly regarded organisation, recognised for its comprehensive policy and technical knowledge on frontline local government services. Promoting excellence in public services, APSE hosts networks for frontline service providers in areas such as waste and refuse collection, street cleansing, parks and environmental services, highways and street lighting, leisure and sports facilities, school meals, building cleaning, housing and building maintenance services.

1.2 APSE believes that whether services are delivered directly, or through other forms of provision, they should be subject to the maximum form of democratic control and scrutiny. The Association supports the involvement of the widest number of councillors in decisions which impact upon the quality and range of services provided to the public and supports transparency in public service delivery and performance information.

1.3 APSE has always supported continuous improvement in the delivery of excellent, cost effective and efficient public services to local communities and believes that effective performance management, and the sharing of good practice, are crucial to continuous improvement of public services. APSE believes that citizen engagement is central to transforming services and that frontline services are an important channel in connecting with service users, including information on how services are performing at a local level and in comparison to others.
1.4 The use of performance management, in feeding into local performance frameworks, which could also be used to assess value for money at a national level, is supported by APSE. Local authorities have developed comprehensive systems over the past 12 years which should, APSE believes, be utilised as this will ultimately lead to a reduction in duplication and the avoidance of costly new burdens. As local authorities improve, APSE supports the reduction in external audit to a more proportionate, risk-based approach, and a culture of local robust performance information, that can be easily understood by the local electorate.

1.5 As a result of the Inquiry and call for evidence APSE has carried out a survey of its membership to gauge their views on the future of performance reporting. These views have been taken into account within this submission and are summarised at Appendix 1.

2. About A performance networks

2.1 A performance networks is a mature benchmarking service which allows for effective performance measurement across a range of 14 vitally important frontline public services and now has 12 years of performance data available. A performance networks is the largest voluntary local government benchmarking service in the UK. It is used by over 200 local authorities with participation growing across all services.

2.2 A service by service area summary of performance indicators is attached as Appendix 2 showing the types of “headline” indicators available. Much more detailed performance information is sourced to produce these “headline” indicators.

2.3 Developed by practitioners the A performance networks model is unique in that it was developed and is continually reviewed by working groups of practitioners. This, combined with working in partnerships with other leading bodies, such as Waste Data Flow UK, ensures that the model continues to be the most relevant, user friendly and responsive of its kind. As APSE is a not-for-profit body it has the integrity of being regarded as an independent provider of performance information, rather than a company geared towards generating a profit. This allows the service to fully evolve and develop in line with its membership base, through local councils, and organically evolve performance information to meet with local and national requirements.

2.4 Whilst at the point of inception A performance networks was designed to support performance management through performance benchmarking, rather than to simply support national performance targets and measurements, the service has successfully collated performance information such as NI 195 on street cleansing and NI 52 on school meals take up. The value of this data to both local authorities and national government should not be understated. The trend analysis that can be gleaned from some of the data available can act as a measure to gauge public policy successes, for example, on local environmental quality. In an era of financial austerity at a local level such measures are useful to ensure that local service quality does not deteriorate and service standards are protected.

3. A’s approach to performance data and service improvement

3.1 The series of performance indicators developed by A performance networks are a combination of compulsory recommended measures suggested by the four main national audit bodies and local performance measures agreed by practitioners. These include cost, productivity, customer satisfaction, quality and human resource management giving a comprehensive view of performance.

3.2 It is recognised that with the abolition of nationally collected datasets and the abolition of the Audit Commission some of the indicators may no longer be collected. However, the vast majority of A performance networks indicators will still be collected as these will continue to help inform service managers, and locally elected members, about how a service is performing and where improvements need to be made. A performance networks will maintain its contribution to continuous improvement in local public services and as a means to ensure frontline service providers can share and learn from best performers.

3.3. APSE has always rejected the notion of data being simply a “flat” process of data collection. We positively encourage participating authorities to share process information to determine where savings can be achieved, and provide comparable data in a meaningful way between “family groups”. The profiling of councils who submit data (to determine a “family group”) to A performance networks, allows similar types of authorities to share meaningful information, rather than simply a process of “near neighbour” information that can often distort or even undermine the comprehension of performance information. In the worst case scenario, where there are no comparators between “family groups” such information, where it is made publically available could mislead the public, local councillors and of course central Government.

4. Interface with government policy and publically accountable public services

4.1 The Conservatives’ localism policy paper, control shift, argued that local government should be free from centrally imposed targets, and that centrally imposed targets limit the opportunity for local councils to tailor local services to local need. control shift also argued that measurements or targets should be about outcomes rather than outputs.

46 APSE performance networks is a registered trade name. All intellectual property rights are reserved to APSE.
4.2 The paper also stated that there should be a shift in reporting arrangements to local residents and communities rather than reporting performance to Whitehall. It went on to explore the concept of councils being driven into a culture of ensuring that they reported on targets and performance rather than demonstrating that they were improving local services.

4.3 The report also promised abolition of all “national process targets” for local government; replacing this instead with a requirement for councils to “publish comprehensible and standardised information about the quality and quantity of frontline services.” APSE has developed a range of performance information over a 12 year period on local frontline service performance which is capable of meeting this requirement.

4.4 APSE’s own views on performance data, shaped by our experience of data collection over the last twelve years in frontline services, is that performance data should be a means to both improve the performance management of public services and ensure a credible, robust and transparent way of explaining to local residents, alongside national government, how public money is being spent, on what local services and how those services are performing within a meaningful mix of value for money, cost, quality and customer or user satisfaction measurements.

4.5 The difficulty with performance data in its purest form is that data can be both complex and misleading. If there are to be genuine efforts to encourage “armchair auditors” as advocated by the Communities Secretary the Rt. Hon. Eric Pickles MP, the collection, audit and presentation of data must be meaningful to local residents and provide a significant value for money benchmark to central government, reflecting the balance of funding to local councils through council tax and central government funding. Government as well as local council tax payers have a right to know that value for money is being achieved.

5. What should a new performance framework look like?

5.1 The drive to minimise bureaucracy and reporting burdens on local councils is of course welcomed within local government. However, there is a poor record of central government genuinely releasing local councils of such burdens, without new burdens being created to replace the ones supposedly lifted.

APSE believes that a broad direction from central government should relate to:

— What types of performance information might be made available;
— The robust nature of the data and an element of independent or peer assessment; and
— The presentation and accessibility of the data to the public and locally elected members.

These elements should, in APSE’s view, be key drivers in forming a new era of performance information in local councils.

5.2 This would be an approach that appears from APSE’s survey information to be preferable to local council frontline service managers and elected members. This would enable them to gauge service performance but at the same time ensure that this performance information is capable of local scrutiny.

Such a framework could draw upon:

— Genuinely comparable performance information across a range of frontline public services, by “family group”.
— Include a “dash-board” of headline indicators in each service area using a mixture of cost, productivity, quality and customer satisfaction scores.
— Provide a “plain English” guide to what data means and how it has been arrived at.
— Provide local elected members with the means to scrutinise service performance and direction of travel for frontline services.

6. Aiding creating new burdens and adding cost

6.1 There is naturally a fear that any new performance framework will simply mean a further “industry” is developed to support a transition process to a new framework, at a cost that would inevitably fall on local councils, at the point that they can least afford it. APSE is therefore keen to suggest that this need not be the case.

6.2 A “light touch” but nonetheless robust performance framework, with scope for the reporting of existing data sources is, and should in APSE’s view, be at the heart of the new framework. This would avoid duplication, could allow for a speedier process of implementation and, by using pre-existing data sources, provide for an auditable pilot process using local council managers, members of the public, local councillors and of course national Government before being formally launched across local government, in advance of a relatively short timeframe for implementation.
7. In addition to APSE’s own performance networks data there are a range of data benchmarking services provided by other organisations, including organisations such as CIPFA. A new locally driven framework could therefore:

- Draw down and report on key data information across a dashboard of indicators culled from existing data sources;
- Sit within a national framework to provide consistency, but with requirements on local councils to be transparent in data information; and
- Ensure that the data sources are robust and validated by independent sources or peers.

7.1 APSE has already worked with the Department for Culture, Media and Sport (DCMS) and others as detailed in Appendix 3 to develop more meaningful performance information. It is the view of APSE, supported by the outcomes of our recent survey, that whilst the public would not be interested in detailed tables of complex data, councils should have the ability to publish some “bread and butter” performance data such as:

- “How much does it cost to empty my bin”?
- “How much does it cost to clean my street”? Or
- “How long does it take the council to repair a street light?”

7.2 This type of data would be of interest and more importantly open up a link between the services provided by local councils, which is often a source of confusion, and what local services cost to run. In the context of reductions in public sector spending this also provides a bit more detail and knowledge about the types of choices, financial and political, that Councils and local councillors in particular face. It provides part of the democratic thread of locally accountable public services.

7.3 ILLUSTRATIVE EXAMPLES OF A DASHBOARD OF INDICATORS PER SERVICE AREA

<table>
<thead>
<tr>
<th>Service area</th>
<th>Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Refuse collection</td>
<td>Cost of refuse collection service per household Missed collections per 100,000 collections Percentage of total waste collected which is sent for recycling Community and customer surveys undertaken</td>
</tr>
<tr>
<td>Street cleansing</td>
<td>Cost of street cleansing per household Percentage of sites surveyed falling below grade B for cleanliness Percentage of street cleansing waste that is recycled Customer satisfaction surveys</td>
</tr>
<tr>
<td>Street lighting</td>
<td>Cost of maintaining street lights Average time to restore lamps to working order Percentage of street lamps not working as planned Public telephone calls contacts as a percentage of faults Community consultation</td>
</tr>
<tr>
<td>Highways</td>
<td>Percentage of highways function cost spent directly on highways repairs Average time to replace lamps to working order Condition of principal and non-principal roads</td>
</tr>
<tr>
<td>Winter maintenance</td>
<td>Cost of salting per km of road treated Average actual response time in hours for completion of planned pre-salting Km length of footways where precautionary gritting was undertaken Customer satisfaction surveys</td>
</tr>
<tr>
<td>Parks, open spaces and horticultural services</td>
<td>Cost of service per hectare of maintained land Number of hectares maintained per employee Quality standards, frequency and chemical control methods Community customer surveys undertaken</td>
</tr>
</tbody>
</table>

7.4 An additional way of presenting this information could perhaps include a comparator table to “family group” authorities showing how one particular council has performed when compared to a similar type of authority. As stated earlier if such information were to be readily accessible, either through council websites or through a short note to council tax bills, this would help to support what APSE believes is the critical point of performance management data which is to ensure there is democratic accountability for local public services.

8. r e ting t e s r e data

8.1 For the public to have confidence in published data there should be safeguards in place to ensure that the source data used is not “corrupted” data either by omission, incorrect calculation or deliberately misleading data. SE r e r an e net r s data was subject to a detailed review by Inlogov (Institute of Local...
Government studies at the University of Birmingham) in 2005 and as a result of that review further processes were successfully implemented to ensure that data is regularly subject to a validation and audit check from peers or industry experts. This includes:

— a process to automatically detect fluctuations within datasets outside of agreed parameters.
— Reject data that is out of kilter within the normal industry limits for further investigation.
— Ensure validation processes take place on source data—for example an evidenced based approach to verify data sources are accurate.
— Peer review to carry out data drilling both to ensure that the data is accurate and identify best performing and most improved performing authorities.

8.2 APSE believes that any new national performance framework should include a process by which any stated data is subject to a reasonable level of robust interrogation.

9. Abolition of the Audit Commission

9.1 With the abolition of the Audit Commission we are concerned that there may be a gap in high quality information on the cost and performance of public services. Whilst the Coalition Government is striving to remove reporting burdens, the ability to access performance data is a vital means by which to measure the efficacy of local services. Whilst not all National Indicators were universally supported a number of these indicators show the direction of travel of local public services. These indicators provide a means by which to ensure that service quality does not deteriorate. In the absence of a collective national body to explore the use of resources at a local level APSE believes that there nevertheless should be an overarching framework to safeguard the use of resources, whilst exploring some commonality in service performance measurement.

9.2 A national framework, supported by local choice over services, would also ensure that Government and local councils are able to maintain an effective measure of public service performance within local government. This is also consistent with exploring the divergent performance regimes throughout UK administrations.

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SURVEY RESPONSES AND SURVEY SUMMARY

1. APSE received over 90 responses from member local authorities to a short survey on the future of performance management. The details below highlight responses but are not intended as a full analysis due to the time constraints of responding to the Inquiry.

2. Of all respondents 69% participate in APSE performance networks with 61% utilising locally developed performance measurement processes and 58% operating informal benchmarking arrangements with neighbouring authorities. 29% benchmark through a professional body and 17.6% currently operate benchmarking through a RIEP on specific areas or work streams.

3. 88.3% of respondents agreed that performance indicators can be a useful measure of value for money with 95% agreeing with the statement that “Performance measurement is necessary to know where you are at so you can make informed choices about future service delivery”.

4. 63.3% believe that performance targets work to improve services but 86.7% believe that performance indicators and process benchmarking work together to improve services.

5. An overwhelming 93.3% of respondents believe that performance indicators should be about a fair combination of service cost and quality but just 1.7% believe that performance indicators should only be about how much a service costs and just 6.7% believe that performance indicators should only be about service quality.

6. 71.2% believe that performance indicators are only meaningful if you fairly compare similar types of authorities or services by profile.

7. 44.6% support a small “dashboard” of indicators per service area with headline costs and quality eg Cost of emptying a bin per household, the cost of a school meal per pupil with 37.5% supporting a small dashboard of headline indicators but only if the comparator information is fairly produced eg by similar authority types for that service area.

8. 60.4% however feel that the information (performance information made public) will only be used by local news media for mischief making rather than genuine public interest reporting.

9. 64.2% are of the view that performance information is complex and over-simplification of performance could mislead the public rather than providing them with good quality information with 62.3% believing that
there is a danger that performance information will lead to the public and media focusing only on cost to the
detriment of service quality.

**Specific Comments Added to the Survey Include**

10. “Any new regime needs to be light touch and concentrate on a few key indicators that are of interest to
the public. The financial pressures facing local government are likely to help flush out areas of waste and
inefficiency more effectively than any performance reporting system.”

11. “Any large and complex organisation needs to have a mechanism to manage its business by setting
clear priorities and objectives, monitoring progress and reviewing plans. Performance reporting on its own is
meaningless, and league tables misleading since they assume we all have the same organisational objectives.”

12. “Benchmarking is invaluable for performance improvement and monitoring. It eliminates complacency
and pushes forward best practice, in turn improving value for money, which must underpin all public
expenditure”.

**APPENDIX 2**

**SUMMARY OF KEY PERFORMANCE INDICATORS USED IN APSE PERFORMANCE NETWORKS**

As standard for all the benchmarking services the following data is provided:
- Cost of service.
- Productivity.
- Staff absence.
- Customer satisfaction.
- Human resources and people management.
- Quality assurance and community consultation.

**Some of the Service-Specific Indicators are Illustrated Below**

1. **Building cleaning**
   This service provides comparators for the cleaning of education and non-education buildings.
   - Square metres cleaned (offices libraries schools public conveniences).
   - Cost indicators (labour management equipment materials).
   - Staff turnover.

2. **Building maintenance**
   This service provides detailed performance information on maintenance of housing and civic buildings.
   - Housing (void turnaround time to re-let, gas servicing, target response times, number of jobs
     completed, value of jobs).
   - Civic (cost of property management incidents of vandalism arson).
   - Stores management.
   - Workforce data.

3. **Civic, cultural and community venues**
   A facility based model where up to 15 civic, cultural or community venues per authority can participate.
   The model looks at:
   - Usage per target group.
   - Cost per user.
   - Visits per household.
   - Primary and secondary income.
   - Catchment area and demographics.

4. **Culture, leisure and sport**
   An authority-wide benchmarking service for cultural, leisure and sport services provided by the authority
   including:
   - Sports facilities.
   - Sports development.
   - Children’s play facilities.
   - Cultural services.
5. **Education catering**

This service provides a benchmark for primary, secondary, special and dedicated all age schools. The focus is on:

- Free and paid meal uptake.
- Nutrient based standards.
- Subsidy cost based indicators.
- Meals served per staff hour.

6. **Highways and winter maintenance**

This service covers the main responsibilities of the highways department.

- Road condition.
- Damage to roads pavements made safe.
- Third party claims.
- Winter gritting salting regime.

7. **Other civic and commercial catering**

This is a facility based model where up to 20 commercial or civic catering facilities per authority can participate. The model focuses on:

- Customer spend.
- Operational recovery ratio.
- Trading profit loss.
- Vending income.

8. **Parks, open spaces and horticultural services**

This covers all aspects of the grounds maintenance service:

- Maintenance cost.
- Hectares maintained.
- Charge per hectare.
- Playgrounds play value scores.
- Environmental practices.

9. **Refuse collection**

This focuses on the waste collection services, with an increasing focus on the recycling services provided:

- Cost per household.
- Recycling.
- Transport and vehicle costs.
- Number of missed bins.
- Domestic and trade waste contracts.

10. **Ports and leisure facility management**

Up to 15 sports and leisure facilities per authority can participate in this service. Facilities are grouped by the type of facility; wet and dry and whether the facility is dual use. In addition reports are produced for the following types of facilities: flumes only, indoor bowls centres, golf courses, gymnastics centres, ice rink facilities, major events facilities, ski centres, stadia, tennis centres, and water sports parks. The model focuses on:

- Subsidy per visit opening hour.
- Total usage.
- Customer spend.
- Catchment area analysis.
- Usage by target group.

11. **Street cleansing**

This service includes a focus on:

- Cleanliness standards achieved.
12. **Street lighting**

This service looks at the performance of the local authority and electricity supplier. The focus is on:
- Lamps not working as planned.
- Time taken to repair lamps.
- Cost of maintaining street lights.
- Energy costs.
- Repairs undertaken by regional electricity supplier.

13. **Transport operations and vehicle maintenance**

The focus is on:
- Contract maintenance.
- Direct maintenance cost.
- Vehicle availability and servicing.
- Prosecutions penalties notices issued.
- Passenger transport.

14. **Welfare catering**

This service provides a benchmarking service for all welfare services provided such as the “meals on wheels” service and includes:
- Subsidy.
- Meals despatched delivered.
- Transport costs.
- Food costs.

### APPE D 3

**USE OF APSE PERFORMANCE NETWORKS DATA BY GOVERNMENT BODIES**

**APSE PERFORMANCE NETWORKS DATA HAS BEEN USED FOR THE FOLLOWING NATIONAL STUDIES**

1. A *performance networks* is recognised as a trusted and robust source of performance data within local government. The model met all criteria in an assessment of consistency, reliability and comparability of data required by the Audit Commission. An Independent Technical Review on Sport and Leisure Facility Equity Indicators undertaken by Professor Tony Bovaird, University of the West of England (March 2006) for the Department for Culture, Media and Sport (DCMS), to assess how well the APSE methodology meets the DCMS and Audit Commission criteria found that a *methodology meets all the Audit Commission criteria*. On ease of collection, the review also found that the APSE methodology does not impose unreasonable burdens on local authorities.

2. A *performance networks* data has also been used by member local authorities to support the requirements to demonstrate effective use of resources within Audit Commission inspections and a host of other public service reporting mechanisms.

3. A Review undertaken by Professor Michael Hughes and Sophia Bokhari of the Institute of Local Government Studies (Inlogov), University of Birmingham (July 2005) found that the model was “well established and trusted to deliver information”. It also stated that well sourced, relevant, and robust performance data from *performance networks* that is actively used in the management of services and the achievement of policy objectives could be an important part of that information councils’ hold about themselves.

4. APSE has been working with Waste Data Flow to reduce the duplication of councils submitting refuse and recycling data to both APSE and Waste Data Flow. As a result, APSE now directly access refuse and recycling data from Waste Data Flow rather than asking councils to send this to APSE as well. APSE concentrate on collecting cost, income and other data directly from councils and source the data collected via Waste Data Flow directly from them.

5. In 2009, the Welsh Audit Office asked APSE to provide a baseline of data to calculate performance indicators for education catering. This included the cost of producing a school meal and the performance...
information was requested as part of Appetite for Life. The project has now been completed and following consultation between the Welsh Assembly Government, the Welsh Audit Office and councils throughout Wales it has been agreed to collect data via APSE on an ongoing basis.

6. APSE has worked with the Welsh Assembly Government on Ffynnon, their Knowledge Management Business Change Programme which aims to create a performance management community and culture across the public sector in Wales. The Ffynnon system is a web hosted performance, risk and project management system which is available to 30 stakeholders across Wales including all 22 Local Authorities. APSE undertook 2 projects in relation to Ffynnon; education catering and building maintenance. The purpose of the projects was to bring some of the data provided to APSE into the Ffynnon system, for ease of reporting, sharing and to reduce duplication. This has now been progressed with a number of local authorities in Wales.

7. APSE was engaged in a project for Audit Scotland in 2009, looking at the management of unit costs in local government. APSE carried out an analysis of performance data, using data drawn from performance networks, for a study by Audit Scotland on physical recreation.

8. In 2002, APSE was commissioned by the Local Government Staff Commission in Northern Ireland to carry out a Local Government Benchmarking initiative; benchmarking seven front line services across Local Authorities and Education Library Boards.

CONTACT INFORMATION

APSE
Association for Public Service Excellence (APSE)
2nd floor Washbrook House, Lancastrian Office Centre,
32 Talbot Road, Old Trafford, Manchester M32 0FP
Tel 0161 772 1810
Fax 0161 772 1811
Website at http: www.apse.org.uk

Contact: Mark Bramah, Assistant Chief Executive
Email: mbramah apse.org.uk
Mobile: 07796301502

Written evidence submitted by anguard Consulting

This submission is concerned only with oversight and inspection of local authority performance. I have no expertise in audit of expenditure but would consider it important that financial expenditure should be assured for probity.

SUMMARY

— Audit is not without value judgement.
— The idea of “best practice” should be abandoned.
— The “value for money” methodology has little to do with value for money.
— “Better” is a more constructive lodestar.
— Responsibility for innovation must be with the innovator.
— Inspection of performance should be limited to one question.
— Citizen redress should be given teeth.

ABOUT VANGUARD

Vanguard helps service organisations change from a “command-and-control” design to a “systems” design. The Vanguard Method enables managers to study their organisation as a system and on the basis of the knowledge gained, re-design their services to improve performance and drive out costs.

AUDIT IS NOT WITHOUT VALUE JUDGEMENT

When the Audit Commission’s role was extended to include performance management it inevitably began to formulate views of what “good practice” is. The adoption of service models including shared services, back-offices, choice-based lettings, schedule of rates, targets, service-level agreements, customer service standards and many other similar features have been promulgated as necessary for compliance through the oversight and inspection processes.

Many of these features fit with politicians’ predilections; thus the Audit Commission became an instrument of government. For example, Audit Commission inspectors have encouraged, some would say coerced, the adoption of shared services, despite there being no evidence as to their efficacy and plenty of evidence of expensive failures which have cost the public purse.
The features listed above do not constitute “best practice”. Worse, they cause sub-optimal performance of the service involved. For example, “economy of scale”, often assumed to be a “no-brainer” by those specifying and inspecting services, is in fact shown to be a myth when applied to the design of services. Industrialised services create their own (“failure”) demand. Recent revelations about HMRC’s performance illustrate: The failure of the industrialised design (call centres, back offices, standardised work, IT-dominated processes, etc) has led to what must be the majority of PAYE taxpayers’ payments being found to be wrong or not “closed” (meaning HMRC is not sure). This and other failures of industrialising services ought to provide caution to those who now seek to provide the newly proposed Universal Credit on-line and through a single national call centre.

While politicians have placed faith in Audit Commission ratings of local authority performance, our studies of Audit Commission performance ratings show problems of validity. High ratings are given for compliance with specifications developed by DCLG, the Cabinet Office and the Audit Commission. When studied as systems, 1-star performers look little different to 4-star performers to their customers.

In summary, the processes of oversight and inspection are replete with value judgements about “good” or “best” practice. The judgements are not grounded in evidence but are based on ideological beliefs about service design. Oversight and inspection activities have contributed directly to sub-optimising performance.

The Idea of “Best Practice” should be Abandoned

Vanguard’s work with local authorities has identified, in practical terms, how oversight and inspection activities have made performance worse in each and every local authority service. Three examples:

* sing ene ts servi e

In 2008 the Audit Commission published a “research” report[^47] which claimed the greatest potential efficiency savings in Housing Benefits services would be made by “partnerships”, meaning either sharing services with other local authorities, or out-sourcing to private-sector providers.

By the time of this report most local authorities had adopted the DWP’s mandated design for benefits processing, a front-office back-office design with associated targets. From this position it was an easy step to share or out-source a “back-office”.

Sir Peter Gershon’s report into government efficiency also concluded that local authorities should share or out-source Housing Benefits processing.[^48]

Local authorities that have studied the Housing Benefits service as a system have found that a front-office back-office design, with associated targets, creates enormous waste. They have also shown that the best design for Housing Benefits is to design the service against demand (or, to use the parlance, a “front-office-only” design). Benefits are processed in a matter of days and typically efficiency gains of 20 to 40% are realised. More importantly because claimants are seen, these local authorities solve the whole problem for people, diminishing demands on other services but most importantly, providing services that work.

* sing e airs

Local authorities that have studied housing repairs know that the schedule of rates (introduced to control costs), the menu of repair targets, the use of standard times and procurement on the basis of cost—all features rated highly by inspectors—drive costs up and worsen service.

Portsmouth City Council’s housing service, to take just one example, has been re-designed. Today it provides repairs to tenants on the day and at the time the tenant wants it. The cost per repair has been halved. It is, by anybody’s standards, an economic benchmark. However, Audit Commission inspectors visited and down-graded their rating of Portsmouth because the features inspectors had been sent to see were not present.

* d t S ia a re

Adherence to the specifications developed by CSCI and now maintained by the CQC means the time it takes to determine an adult’s needs is extraordinarily long, requires multiple visits by different functions and is confusing for the adults requiring help. For example, in one local authority it was learned that for every £100 spent on care £1,000 was spent in administration (establishing the need for this care to be provided). While all of the functions within this service may be meeting their targets, and the service may be highly rated by inspectors, the customers’ experience was dreadful. Often those who need care suffer deterioration in their conditions.


[^48]: Gershon, P 2004 “Releasing resources to the front line: Independent Review of Public Sector Efficiency” HMSO, Norwich. See for example the recommendation on page 43 to “rationalise the number of providers of the same transactional services, such as housing benefit, thereby delivering significant economies of scale”
Local authorities that have studied their systems have used this knowledge to design the service against demand and hence improve the service—people get their problems solved in short times—and this reduces costs in three ways: the costs of administration, the costs of equipment provided and, by far the largest saving, the costs associated with driving people into care homes.

At this time care services are still subject to the specifications originally developed by CSCI. The Munro review into children’s services will report on regulation. Professor Munro’s findings will be relevant to all care services.

The above observations are true for all local authority services. The idea of “best practice” being promulgated by the centre and reinforced through inspection must be abandoned.

THE “VALUE FOR MONEY” METHODOLOGY HAS LITTLE TO DO WITH VALUE FOR MONEY

The Audit Commission’s “value for money” methodology is based on the measurement of cost, with a particular focus on unit cost. It is both misleading and damaging. Managing costs creates costs.

Consider, for example, local authorities’ compliance with the 2005 target to establish call centres. It was based on the notion that telephone calls are a cheaper way to provide a service. In every case studied, compliance led to a rise in the volumes of calls (failure demand). The true costs of service are represented by the total number of transactions it takes customers to get a service. The pursuit of lower transaction costs drives costs up.

The “value-for-money” calculation for museums and galleries is the percentage of the population that has visited divided by the cost of the services per head. It teaches us nothing about value and will lead to dysfunctional decision-making.

In housing repairs, service “costs” are measured through the schedule of rates. Very often the low-cost providers are also those that have to visit tenants repeatedly. The schedule of rates was introduced to control costs but in practice it only drives costs up. The same phenomenon is found in health commissioning, it is inflating costs.

The Audit Commission’s Key Lines of Enquiry for housing repairs encourages the use of “modern procurement methods and partnerships”. The “professional” procurement industry which has grown around out-sourcing repairs ensures that only the larger providers that employ the schedule of rates, targets, standard times and workforce management systems—all considered “best practice”—will get the work. All of these features have been abandoned by housing organisations that have adopted the systems approach because they have learned how these things only drive costs up.

To know about the cost of anything is to know nothing useful; any action risks making things worse. Studying local authority services as systems has given managers knowledge about quite different things: the nature of demand (what do people want from us?), the capability of the organisation in providing it and the costs of failure to do so. By designing their services against citizens’ demands and managing value they have driven costs out of their organisations.

The “value for money” methodology has nothing to do with value and, with its focus on cost, serves only to reinforce poor-quality management thinking. While the Audit Commission regards “value for money” studies as “can-openers” on management’s problems, I regard them as leading to a misunderstanding of the problems.

“BETTER” IS A MORE CONSTRUCTIVE LODESTAR

“Best practice” is a static idea. It leads us to think we should copy others. Father of the Japanese post-war revival W. Edwards Deming taught that copying without knowledge is dangerous. The genius behind the development of the Toyota Production System Taiichi Ohno taught that visiting others was looking in the wrong place. He showed how everything you need to know to improve your organisation is within it; you simply need to learn how to look at it differently.

Benchmarking “best practice”—comparing to and visiting others—is the fastest way to mediocrity.

Anything can be improved, even the best. “Better” is a dynamic idea and is therefore a better lodestar for local authorities’ performance management.

RESPONSIBILITY FOR INNOVATION MUST BE WITH THE INNOVATOR

The vital feature of the coalition government’s removal of targets and central specifications is the shift in the locus of control. The previous regime ensured only compliance with the centrally-set specifications. To innovate we need responsibility in the right place, where the services are provided. To that end local authority managers must be completely free to choose on all matters of method and measures when designing and managing their services.
Inspection of Performance should be Limited to one Question

If there is any inspection of performance, and in my view it should not be necessary, the inspector should be limited to asking one question:

“What measures are you using to understand and improve performance?”

The question maintains the locus of control with the local authority manager. Having been told the answer, inspectors should then look for the use of the same measures in the work-place. This will radically increase the validity and reliability of inspection while also reducing its costs.

The same measures should be published locally.

Citizen Redress should be Given Teeth

Citizens want services that work. With most services citizens do not want to be asked to design them or control them; they just want those services to work. When they don’t work the citizen's first port of call should be their local representative who, after all, was elected to do exactly this. If that fails, redress should be provided to a body with the power to investigate and take whatever action is required. Both steps should be given teeth.

Professor John Eddie
Vanguard Consulting

January

Written evidence submitted by Deloitte P

Executive Summary

We have pleasure in submitting comments and views on the above topic following the Committee’s decision to review the proposed abolition of the Audit Commission. Our key points are:

— We are supportive of the separation of the regulatory functions of the Commission from all audit providers. Our firm’s external audit work for companies, charities and NHS Foundation Trusts is already subject to regulatory oversight by the Financial Reporting Council (FRC) and the professional Institutes.

— We consider that protections will need to be built into any new regulatory regime for exceptional circumstances that may arise which could prevent local audit being carried out without fear or favour. Some protection would be brought if audit committees were made mandatory for local authorities and they were required to comprise full membership, or a majority, of independent members.

— We believe that the power of the auditor to produce a public interest report should be reconsidered. If all reports submitted by auditors to Audit Committees were made publicly available, then matters of an urgent nature could readily be brought to public attention without additional reporting responsibilities being imposed. New legislation could require the audited body to have to respond to any non-standard audit report or a report requiring a formal response to a significant matter within a designated timeframe.

— As audit standards already require the lead audit personnel to have to rotate, we see no reason to impose a fixed or recommended term for audit appointments. This should be left to local choice, in our view.

— We believe that the current changes to the legal provisions governing local public audit should include new provisions requiring all local audited bodies to produce a “corporate style” Annual Report alongside their accounts.

— Reporting explicitly on the regularity of expenditure at a local authority would add to audit costs, since the amount of work involved would be disproportionately expensive. We consider that the regularity requirements of parliament are best served under any new local public audit regime by retaining the facility for specific grant certification. The NAO is likely to be the appropriate agency to ensure that any such requirements are proportionate.

— The Companies Act provisions relating to proportional auditor liability and to liability limitation agreements (including a negotiated cap) would be equally appropriate here.

— We consider that the abolition of the Audit Commission takes away a layer of regulatory oversight that can readily be integrated within the other existing audit quality and regulatory arrangements.

— We believe that existing and new firm entrants into this market will have sufficient resources to be deployed in this market to handle the planned introduction of local audit competition.

— There is some advantage to spreading the phasing of local audit tendering over a transition period, but not over such a long period that the potential benefits of the new local audit appointment regime are delayed unduly.
We have provided more detailed comments below. As a firm who has had a longstanding involvement in providing external audit services to a wide range of local public bodies, including local authorities and NHS organisations, we are grateful for the opportunity to comment on the implications of the government’s announcement to abolish the Audit Commission in 2012. We are encouraged that the Committee is giving this decision appropriate scrutiny, particularly in determining the structure of any new external audit arrangements for local public bodies.

1. Audit Regulation

1.1 We are supportive of the separation of the regulatory functions of the Commission from all audit providers. Our firm’s external audit work for companies, charities and NHS Foundation Trusts is already subject to regulatory oversight by the Financial Reporting Council (FRC) and the professional Institutes. These regulators spend considerable time and effort challenging our audit processes and systems and reviewing our detailed audit work. The FRC publish reports each year on the outcome of their reviews. The Institute of Chartered Accountants in England and Wales (ICAEW) determines those members who qualify to be Responsible Individuals and hence can lead audit engagements and sign external audit reports in their own name. We believe that there is no overarching reason why the oversight of local public audits could not be similarly overseen by these regulatory bodies. This will reduce the regulatory burden on firms, as many of our audit systems and processes are common between the corporate and public sectors. We think that the public should be able to take assurance from these regulatory arrangements provided there is continuation of reporting in public of the outcome of regulatory reviews and of the list of persons accredited to be Responsible Individuals and hence lead the audits of local public audits.

1.2 There has been discussion on whether there should be additional accreditation requirements to be a firm and a Responsible Individual able to undertake local public audit engagements. We believe strongly that adding additional accreditation criteria just for this market is not necessary. The current criteria applied to accredit audit firms and Responsible Individuals (who can lead audits and sign audit reports) are sufficient to ensure only suitably qualified audit professionals are given Responsible Individual status. The criteria that may be important to individual audited bodies as to what other additional skills and experience they want to see from their auditor should be left as a matter for local choice, just as it is in other sectors of the economy.

2. Audit Independence

2.1 One of the elements in the current public sector audit regime is independent audit appointment. This applies in central government with the National Audit Office and the Comptroller and Auditor General being responsible for all audits. At a local level, parts of the public sector already have the ability to appoint their own auditors. For example, the higher and further education sectors and NHS Foundation Trusts. In both these cases, there remains a separate regulator to whom the auditor can report in extremis and who helps define the scope of audit work and reporting required from the local auditor.

2.2 We consider that protections will need to be built into any new regulatory regime for exceptional circumstances that may arise which could prevent local audit without fear or favour. In part, this may depend on the revised scope of the audit, on which we comment below. Where the auditor is in need of most protection potentially is when the auditor is undertaking elector challenge work (so called “objections”) or pursuing a matter considered to be of public interest (which currently lead to Public Interest reports). It is not difficult to imagine circumstances where an auditor identifies some alleged wrongdoing at an audited body that could have implications for elected members as well as officers. Some protection would be brought if audit committees were made mandatory for local authorities and they were required to have either a complete membership, or a majority, of independent members. This would go some way to mirroring the position at NHS bodies where, despite having a unitary board, the Audit Committee has to be made up exclusively of Non-Executive Directors. However, the question remains as to whether the potential involvement of independent members on local authority audit committees will be sufficient to protect the auditor both in terms of reporting wrongdoing and getting paid for such work.

2.3 We also have concerns as to whether there are enough suitably qualified candidates across the country who would be willing to become independent members of local authority audit committees. Perhaps CIPFA, the ICAEW or other professional body could be required to establish and maintain a central register of independent people appropriate to serve in this capacity.

2.4 A further aspect of audit independence is length of appointment. In the private sector, auditing standards require rotation of the lead auditor. Rotation of the senior audit leadership is designed to prevent close
associations building up to prejudice auditor independence, whilst recognising that too regular rotation either of individuals or firms creates inefficiencies and risks ineffective audits. In fact, many audit clients request greater rather than reduced team continuity, since change in audit personnel can create additional burdens on the audited body. As audit standards already require the lead audit personnel to have to rotate, we see no reason to impose a fixed or recommended term for audit appointments. This should be left to local choice, in our view. We recognise the merits of occasional audit tendering, but we do not consider a mandatory audit appointment period should be imposed.

3. Responsibilities of Audited Bodies

3.1 Critical to the changes to the local public audit regime are the responsibilities of the audited bodies. The statutory requirements on local authorities for producing annual accounts and related reports are somewhat different to those for NHS bodies. NHS trusts (and NHS Foundation trusts) are required to produce an Annual Report and accounts, much in line with the corporate sector. Local authorities are not currently required to produce an Annual Report with their accounts. Neither a local authority nor an NHS body has to include a clear statement in the report accompanying the accounts or in the Annual Governance Statement (or Statement on Internal Control for NHS bodies) on how they have delivered value for money for their local people. Hence, despite the current statutory requirement on auditors to satisfy themselves on the value for money arrangements at an audited body, they cannot reference their work to an audited body’s formal statement about how it has organised and delivered value for money.

3.2 We believe that the current changes to the legal provisions governing local public audit should therefore include new provisions requiring all local audited bodies to produce a “corporate style” Annual Report, which should include a summary of the audited body’s performance and prospects, the risks it faces and how these are being managed, and, either in the Annual Report or in the Statement on Internal Control, there should be a requirement for a section describing how the audited body achieves and has achieved, value for money for its various stakeholders, including how the audited body has assessed this achievement. Audit work is facilitated at an audited body, they cannot reference their work to an audited body’s formal statement about how it has organised and delivered value for money.

4. Audit Scope

4.1 The scope of local public audit is wider than that for company audits. This recognises the important role the auditor plays in reporting on the accountability of local audited bodies for their use of public funds. It also recognises the role the external auditor can play in being a vehicle for independent challenge and investigation should local electors have concerns about stewardship or legality aspects of their local authority.

4.2 Although these audit powers have been in place over a long period, recent legislative changes provide the opportunity to modernise them. For example, the Freedom of Information Act and the new transparency requirements on local bodies to publish all their expenditure data make access to information so much easier for local people. There are also formal complaints processes as well as scrutiny (or equivalent) groups and committees. Hence, we consider that the extended audit powers to hear and pursue elector objections should be dispensed with, as they have increasingly tended to involve considerable audit expense on matters of concern for individuals, sometimes of a legal nature, where such matters are best addressed either through direct dealings with the audited body or through other dispute resolution channels. Reviewing the powers of the Local Government Ombudsman may be required to provide the failsafe mechanism for anyone who cannot otherwise obtain satisfaction or resolution of a local issue of concern.

4.3 We believe that the power or the auditor to produce a public interest report should be reconsidered. Whilst it can give comfort that significant local matters can be given serious consideration by the audited body and auditor, there is a risk that local electors see the auditor’s public interest powers as being there to pursue minor or individual concerns.

4.4 Options for change would therefore include dispensing with public interest reporting and leaving the auditor with two responsibilities: to report on the annual accounts and on the value for money arrangements. This is still a broader scope than for a corporate audit. Many issues that have public interest could be covered within a properly defined set of detailed responsibilities for the value for money part of the audit. Further, if all audit reports were made publicly available, then matters of an urgent nature could readily be brought to public attention without additional reporting. Simplifying the audit responsibilities in this way would help limit cost and bring the role more into line with the corporate sector. New legislation could require the audited body to have to respond to any non-standard audit report or a report requiring a formal response to a significant matter within a designated timeframe. This would be a marked improvement to the present arrangements under which a late or qualified audit report does not require any formal publicly available response from the audited body.

4.5 The more detailed requirements on auditors for reporting matters by way of exception, and for addressing specific aspects of value for money, should be left for inclusion in a Code of Audit Practice and related auditor guidance. The responsibility for producing this Code should that of the National Audit Office (NAO), given their understanding of auditing standards and value for money work.
5. Audit Guidance

5.1 As noted above, there is likely to remain a need for a Code of Audit Practice, which has statutory status, and for related auditor guidance. How such guidance is produced and disseminated remains open to options. Under the NHS Foundation regime, there is an Audit Code but other guidance to achieve audit consistency and shared understanding is achieved through a Technical Issues Forum—essentially a group of senior audit firm representatives which meets three or four times a year to consider accounting and audit developments. The minutes of such meetings are published on Monitor’s website. A similar structure for local authority auditors could be established, under the auspices of the NAO, since, through such discussions and publication of meeting minutes, there is a reduced need for production and distribution of detailed audit guidance.

6. Auditor Protection

6.1 The Audit Commission provides an element of protection to the local auditor through their indemnity in the event that the auditor incurs costs in exercising special powers for objections. If the auditors’ responsibilities and powers are reduced as recommended above through the removal of the formal objection powers there would be a reduced need for indemnity protection for the local auditor. The Companies Act provisions relating to proportional auditor liability and to liability limitation agreements (including a negotiated cap) would be equally appropriate here.

6.2 In relation to areas of dispute or disagreement with the local audited body, there needs to be provision for an auditor to obtain settlement of reasonable audit costs in the event that the local audited body does not agree to paying them. Introducing enhanced, mandatory, Audit Committees with a majority of independent members would help in this regard. There also needs to be provision for an independent mechanism to resolve disputed audit fee matters.

7. Auditor of Last Resort

7.1 There has been recent comment that a small number of audited bodies may find it difficult to find an auditor willing to accept the audit appointment under the proposed new local public audit regime. We understand that it is proposed that the new legislation will include a new duty on local audited bodies to appoint an external auditor. If this duty is not exercised, perhaps within a set time period, there would appear to be a need for some remedial action. In relation to whether CLG or another agency should have powers vested in them to make an appointment in such circumstances, our view is that there is normally likely to be at least one audit firm prepared to take on an audit. However, it needs to be recognised that audit costs may increase for any audited body where, either through its location or perceived risk, a number of audit firms are reluctant to take on the audit appointment. We believe that perceived or actual audit risk may be a greater barrier to local appointment choice than the location of the audited body. Audit Ethical Standards require any auditor to assess before accepting appointment the risks associated with the appointment. In the exceptional circumstances of potentially difficult elected member or member officer relationships, it is conceivable that many audit firms may view the reputational and financial risks of the audit at a handful of audited bodies as being unacceptable.

8. Audit Market

8.1 We are of the view that there is, and will be, sufficient capacity to maintain comprehensive and quality audit coverage once local audit choice is made available. We believe that existing and new firm entrants into this market will have sufficient resources to be deployed in this market to handle the planned introduction of local audit competition.
9. Audit Quality

9.1 Audit firms are already subject to considerable scrutiny and oversight by regulatory bodies such as the Audit Inspection Unit (AIU) of the Financial Reporting Council and the Quality Assurance Department (QAD) of the ICAEW. Audit firms are also required to publish an Annual Transparency Report setting out how they ensure their audits meet the required quality standards. We consider that the abolition of the Audit Commission takes away a layer of regulatory oversight that can readily be integrated within the other existing audit quality and regulatory arrangements. We see no reason for establishing any new additional quality oversight arrangements for local public audit, other than, perhaps, to ensure that the wider aspects of the local public auditor responsibilities are specifically addressed both by firms, in their Transparency Reports, and by the AIU and QAD in their review programmes on firms.

10. Transition

10.1 The transition from the current to any new audit regime needs to be considered carefully, particularly as this may be happening at a time when local audited bodies may be experiencing serious financial challenges. Launching sector-wide audit tendering creates a challenge for both audited bodies and audit firms. There is some advantage to spreading the phasing of local audit tendering over a transition period, but not over such a long period that the potential benefits of the new local audit appointment regime are delayed unduly. Under the existing Audit Commission regime, it is possible to extend existing audit appointments. This could be done in such a way as to stagger the end of those existing appointments over say two to three years.

11. NHS

11.1 The proposed new local public audit regime affects both local government and NHS sectors. The NHS is being subject to considerable structural change under this government’s health reforms. Primary Care Trusts (PCTs) and Strategic Health Authorities (SHAs) are to be disbanded by March 2013. OP Commissioning Consortia are to be established as local statutory bodies responsible for commissioning healthcare services from NHS provider organisations. Hence, there is a case for retaining existing audit arrangements for PCTs and SHAs until their demise—this would most sensibly be done by simply extending the Audit Commission’s life for a further year beyond the announced abolition ion 2012 to oversee the last audits of NHS demising bodies.

11.2 NHS Trusts yet to become NHS Foundation Trusts are being encouraged to prepare for Foundation Trust authorisation as soon as possible and no later than 2014. Hence all NHS Trusts should have local auditor choice as they move into Monitor’s regulatory regime. Again, there may need to be some auditor appointment extensions where NHS Trusts follow a slower trajectory toward Foundation Trust status.

11.3 For the new GP Commissioning Consortia, there is little information to date as to their status, legal form or governance structures. One of the main policy objectives behind the proposed changes to the local public audit regime is to shift power away from Westminster. Local choice and accountability seem to be guiding principles. We consider that GP Commissioning Consortia should be established with robust constitutional and governance arrangements so that the local taxpayers and service users can be assured as to how well the money at their disposal is being applied. Such structures should include boards, audit committees, locally elected members and a governor group sitting above the board and holding it to account. This could be similar to the Foundation Trust model. The local authority should also have reserved positions either at board or governor level to ensure appropriate democratic legitimacy. With such robust governance and accountability structures in place, we believe it would be appropriate, and consistent with the other elements of this change agenda, for GP Commissioning Consortia to be able to appoint their own auditors.

12. LG Performance/Risk Indicators

12.1 One of the features of the proposed new local audit regime will be the potential absence of an organisation other than either the CLG or Department of Health to stay abreast of emerging and sensitive issues at a local level and watch over the action taken to prevent such issues escalating into more serious problems. We do not consider large-scale inspection, or nationally onerous and specified, performance monitoring to be appropriate. We do however see a place for a small suite of nationally consistent indicators of performance, covering both financial and service performance. The model of NHS Quality Accounts is worth considering in this regard. These require an NHS body to present both historic and forecast performance information, describe their performance monitoring arrangements and set out local targets for improvement. They also require review and comment before publication from other local stakeholders. Some core sector-wide performance indicators as well as local ones enable both the ability to benchmark between bodies as well as local differentiation and prioritisation to be reflected. We therefore encourage the development nationally of a limited suite of suitable core indicators of financial and service performance which would be able to serve as early warning and reassurance for local people about the comparative performance of their local authority or GP Consortia.

13. Financial Reporting Regime for LG

13.1 Whilst the NHS has for some time adopted a largely “corporate-style” format for annual accounts, and this has been particularly true for NHS Trusts, the accounts of local authorities remain complex as they seek
to balance generally accepted financial reporting requirements against the needs of local tax based allocation accounting. We believe that a move to simplify local authority accounts and bring them more into line with corporate reporting standards and disclosures is likely to bring significant savings. There could remain separate reporting, say through Council Tax leaflets and other media, for the tax-based accounting still to be evident. However, a thorough review of local authority accounts is strongly encouraged, going back to defining the core purpose of the Annual Report and Accounts of local public bodies and resulting in financial statements that are broadly comparable to the commercial sector and therefore more meaningful to members of the public.

January

Written evidence submitted by BD P

1. EXECUTIVE SUMMARY

1.1 BDO LLP is the award-winning UK member firm of the BDO international network, the world’s fifth largest accountancy organisation, with more than 1,000 offices in over 100 countries. We are one of the UK’s top six providers of audit and assurance services. Our public sector clients include the Audit Commission, the Higher Education Funding Council for England, the Learning and Skills Council and local authorities. We are a supplier to the Audit Commission, performing limited assurance audit and related services to “small bodies”. We are committed to developing our business, including audit, in the local government sector.

1.2 We are pleased to have the opportunity to submit written evidence to the Committee’s inquiry into the audit and inspection of local authorities and welcome the Committee’s examination of this important issue. Our submission focuses on our areas of our direct experience. We would welcome an opportunity to give oral evidence to the Committee and are happy to provide additional information.

1.3 The scale of public bodies currently audited by the Audit Commission, ranges from principal bodies, such as local authorities and NHS bodies, to small bodies, such as parish and town councils. These bodies have varied obligations and assurance needs which can best be met by a range of assurance suppliers that reflects this diversity. Five private sector firms currently carry out around 30% of the Audit Commission’s audit work accounting for fees of £45 million. This compares to 13 firms undertaking 15% of audit work when the Audit Commission was first established in 1983.

1.4 We believe the disposal of the Audit Commission’s audit practice to a diverse range of large, medium and small sized firms in the private and third sectors presents the most effective way to create lasting competition and reduce the cost of providing audit and assurance services to public bodies. A concurrent review of the regulatory framework is warranted and we believe should result in greater alignment with private sector reporting while retaining public interest and value for money reporting.

1.5 Therefore, a transfer to multiple bidders should be pursued as quickly as possible to avoid further regulatory uncertainty. We would support a partial buy-out to create an employee mutual as an additional independent player in the market.

1.6 The sale process will need to be carefully designed to balance capability with long-term value. Long-term value should not be assessed solely against the typical sale objective of maximising disposal consideration, but factor in disposal consideration, mitigation of legacy obligations and the sustainability of audit cost savings through competition.

1.7 To enable the maximum number of firms to bid for contracts, we recommend:
   (a) Bidders should be evaluated on their ability to build on acquired contracts (and staff transferred under TUPE) not solely on their prior experience in public sector auditing.
   (b) Contracts should be aggregated on a regional, national and sector basis to create diverse portfolios of various values attractive to a range of bidders.
   (c) The Government should retain accrued pension liabilities and certain other obligations, as Government is able to fund these liabilities more cost effectively over the long term.
   (d) A transitional period of contractual protection, during which successful bidders, notably new entrants to the market, are partially protected from re-tendering is necessary to create the conditions for sustainable competition.

1.8 We believe that a panel (or panels if Local Government and NHS needs vary significantly) of approved auditors should be established to facilitate cost effective access to audit firms deemed fit by the relevant regulator. Use of such a panel should not be mandatory, but provide a route to reduce the costs of procurement and take advantage of Government purchasing power. The existing regime for small bodies (up to £1 million turnover) is working well and should be extended to those spending up to £6.5 million in line with the private sector audit threshold with additional transparency requirements to facilitate public scrutiny.

In conclusion, we believe that a process designed to transfer the audit work undertaken by the Audit Commission to a plurality of providers, reinforced by a flexible approach to accrued pension obligations, will deliver long-term value for money by creating a sustainable increase in competition in the audit market. We fully support this aim.
2. Objectives

2.1 Having made the decision to abolish the Audit Commission, it is now crucial that the way in which the policy decision is implemented provides maximum opportunity for Government in its widest sense (ie both local and national) to achieve maximum value from the process. Value should be measured not only financially, but against a wider set of objectives that abolition should set out to achieve. We believe the Government should seek to achieve the following four objectives:

1. Maintain and improve public confidence in public sector financial reporting. Taxpayers require information that is relevant, reliable, understandable and timely. High quality, cost-effective and independent verification and audit of this information is therefore essential.

2. Facilitate understanding and public scrutiny of public sector spending. There undoubtedly remains a need for accountability and transparency of public expenditure and how public bodies secure value for money in their use of resources.

3. Reduce the cost of audit work through the creation and maintenance of greater competition in the public sector market.

4. Signal Central Government’s desire to promote and sustain a more plural public and private sector audit market. By prioritising the creation of long-term competition in the public sector audit market when implementing the abolition of the Audit Commission, the Government can send a strong signal to users of audited accounts that a wider range of audit firms have the skills, capacity and willingness to participate in the whole of the audit market.

2.2 Objectives 1 and 2 set out above can, we believe be best handled by the creation of an appropriate regulatory framework, potentially under the auspices of the Financial Reporting Council. We believe that aligning the public and private sector financial reporting and auditing frameworks should, in the absence of specific reasons for retaining different requirements, be an objective of Government. The benefits of such an alignment include access to an expanded pool of financial expertise, cross fertilisation of ideas and a general reduction of the barriers to the transfer in either direction of people.

2.3 With regard to objectives 3 and 4, we believe that Government has a significant opportunity to facilitate a step change in the level of competition in the audit market as a whole. The scale of public bodies currently audited by the Audit Commission, ranges from principal bodies, such as local authorities and NHS bodies, to small bodies, such as parish and town councils. These bodies have varied obligations and assurance needs.

2.4 We believe that the abolition of the Audit Commission gives an opportunity for the reassessment of their needs and that the diversity in these needs can best be met by a range of assurance suppliers that reflects this diversity. We believe that giving public bodies the freedom to appoint their own independent auditors will create a more plural and competitive market and is the best way to drive and keep costs down.
3. ROUTE TO ABOLISH THE AUDIT COMMISSION

3.1 We believe that there are four principal ways in which Government could reconfigure the audit services currently provided by the Audit Commission. A summary of these routes and the principal pros and cons is presented below:

<table>
<thead>
<tr>
<th>Option 1</th>
<th>Provides a mechanism to maintain competition by spreading contracts across firms.</th>
<th>Unlikely to generate short term value to Government.</th>
<th>The complete contracting-out of audit work to private firms represents an evolution of the current structure of the Audit Commission and is potentially the simplest option available.</th>
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<td>Fully contract-out the remaining 70% of audits carried out by the Audit Commission to private firms, with Central Government retaining solely a commissioning and regulatory role</td>
<td>Could generate cost savings. Bought-in services have realised savings of £30 million over five years. Recently renegotiated contracts have produced further savings of £11 million over the period to 2016–17. Economies of scale can be achieved through the same firm auditing different bodies in the same geographical location (assuming contracts would be structured and awarded in such a way). Facilities the (continuation of) pooling auditors’ costs to spread, what could otherwise be, significant regional variations from free market pricing. Emphasises the independence of the audit role, by the appointment being made centrally rather than by the body being audited.</td>
<td>Retains central control over audit appointment. Potential for incumbent providers to dominate unless competition is prioritised over the short term. TUPE and pensions transfer negotiations may be lengthy and complex. May reduce incentives to innovate</td>
<td>Contracting-out has in the past reduced prices significantly and would most likely extend lower prices to much of the market. In effect, it would facilitate the “management” of the market, potentially to maintain competition. The Audit Commission (or another Central Government body) would retain solely a commissioning and regulatory role. However, this route does not create freedom to appoint with the customer, which does not appear to satisfy the policy objectives of CLG by creating a free market.</td>
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<td>Option 2</td>
<td>May provide short-term value for Government.</td>
<td>Does not meet the objective of increased competition in the audit market.</td>
<td>This is in our view, unlikely to generate significant additional competition in the public sector audit market.</td>
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<td>Sale of the audit practice as a whole with no further commissioning role for the Audit Commission (or other Central Government body)</td>
<td>Continuity in customer relationships, contracts and staffing.</td>
<td>Incumbents capable of outbidding new entrants, potentially allowing Big 4 dominance of the public sector audit market.</td>
<td>Market incumbents are likely to be capable of outbidding new entrants as they have better knowledge of the market and existing divisions into which to absorb the new business.</td>
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<td></td>
<td></td>
<td>TUPE and pensions transfer negotiations may be lengthy and complex.</td>
<td>It is probable that only Big 4 firms have the infrastructure and resources to execute an acquisition on this scale—the audit revenues exceed those of all other UK firms. As a result, any auction process is unlikely to attract many, if any, potential new entrants to the market. There would therefore be a strong chance that an outright sale would result in Big 4 dominance of the public sector audit market.</td>
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<td>Less likely to generate or maintain long term cost savings.</td>
<td>This in turn is unlikely to create the competitive conditions for the cost savings already achieved by the Audit Commission through outsourcing audit work to the private sector to be maintained in the long term.</td>
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<tr>
<td>Option 3 Break-up and transfer to the private sector</td>
<td>— May provide short-term value for Government. — Could create greater competition. Multiple, small lots would be attractive to and within reach of more bidders, allowing new firms to enter the public sector audit market. — Likely to generate short-term cost savings. Bought-in services have realised £30 million over five years. Recent renegotiated contracts have produced further savings of £11 million over the period to 2016–17.</td>
<td>— May favour incumbents with existing public sector audit practices. — TUPE and pensions transfer negotiations may be lengthy and complex. Disperses knowledge and expertise of public sector auditors (although this can also be a “pro” in the context of developing a wider market). — May be disruptive to customers.</td>
<td>— This is, in our view, most likely to allow the creation of greater competition. A diverse market can best be met by a range of audit firms. Any tender process should be designed to facilitate the maximum number of firms to bid for contracts. New entrants will need to invest in people, training and systems in order to build the expertise necessary to service the public sector audit market. We believe that a period of contractual protection, especially for new entrants, is necessary to create the conditions for sustainable competition.</td>
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4. **Recommendations**

4.1 **Regulatory framework**

4.1.1 The existing regime for small bodies that spend up to £1 million (c9,800 bodies) is working well and should be retained. It provides a proportionate amount of scrutiny by independent firms working to a code of practice with obligations to make Public Interest Reports where breaches of regulations are identified. We believe that reliance on internal auditors to carry out this task or any replacement assurance work, as has been suggested by some commentators, could reduce the quality of work and in many cases challenge independence.

4.1.2 An alignment of the regulatory framework with the private sector in terms of accounting thresholds (£6.5 million turnover) and the removal of the need for an audit would seem appropriate. The small bodies regime should therefore be extended to bodies spending between £1 million and £6.5 million (c100 bodies).

4.1.3 Public interest reporting has acted as a powerful tool to ensure public bodies address their responsibilities as they are keen to avoid any adverse reporting. Accordingly, this duty should be retained and a process will be required to mediate on who should bear the costs in contentious cases.

4.1.4 Auditors of local government bodies also have specific responsibilities to members of the public who have the right to ask questions about the accounts and make objections to them. The wider scope of public audit reflects the accountability of the public body to its electors and tax payers. The normal performance measures on directors to deliver shareholder value do not apply as the shareholders of the public body is a taxpayer who demands accountability in terms of high standards of propriety and the best use of scarce resources. The auditor in the public sector therefore has to review corporate governance, both legal and propriety, and review arrangements to secure value for money and separately report thereon. The costs of dealing with electors’ questions or objections can be disproportionate to the issues raised and a mediation process will be required to agree what should be investigated and who should bear the costs.

4.1.5 A number of the Audit Commission’s roles will continue to be required, including setting codes of practice and ensuring all bodies are subject to an audit or review. This could be absorbed by existing organisations such as the Companies House and the Audit Inspection Unit (AIU).

4.2 **Abolition of the Audit Commission**

4.2.1 In light of the above analysis, we believe that the optimum route to achieving the Government’s policy objectives is the break-up of the Audit Commission and the transfer of its audit functions to the private sector (option 3 above). This could be combined with a partial employee “buy-out” (option 4 above), creating an independent additional player in the market.

4.2.2 The creation of an employee mutual or similar structure would be consistent with wider government “Rights to Provide” policy to encourage employee ownership, facilitate the retention of extensive public sector audit knowledge and expertise in one place and provide valuable continuity in customer relationships.

4.2.3 The creation of greater competition starts with maximising the scope for a diverse range of audit firms to bid for contracts—large, medium and small-sized audit firms as well as incumbents and new entrants. We, therefore, recommend that the Audit Commission’s client base should be divided into a wide range of portfolios of contracts. These portfolios should be regionally based allowing local as well as national firms to bid for portfolios. Subject to the regulatory regime, it may be appropriate to split local authority and NHS bodies into separate portfolios.

4.2.4 The tender process will need to be carefully designed to achieve the objectives set out above. Specifically, the bidder assessment criteria need to balance capability with long-term value. Capability covers:

(a) Expertise—we would envisage that many existing Audit Commission staff would transfer to successful bidders under TUPE regulations. Accordingly, a track record in public body assurance work should not be heavily weighted. Instead, evidence to demonstrate the ability to integrate a new team and provide leadership and management should be assessed.

(b) Quality—an assessment of bidders’ regulatory quality should rely on their overall compliance record, as evidenced by AIU reports and in the areas of tone at the top leadership, systems and processes. Knowledge and expertise should be assessed in the context of the Audit Commission staff transferring to the bidder.

(c) Independence—audit independence should be in line with existing Auditing Practices Board (APB) guidance and will be a statement of fact based on the regulatory conditions applicable under the new regime.

(d) Scale and regional coverage—while a minimum firm size is likely to be necessary in practice, we do not believe specific thresholds should be set. Existing ethical guidelines could be used instead. The sufficiency of bidders’ operations must be assessed in the context of the contracts being bid for.

4.3 We believe that long-term value should not be assessed solely against the typical sale objective of maximising disposal consideration. Rather the value criterion should be long-term value to the public sector as a whole taking into consideration the time values of: any disposal consideration, any mitigation of legacy obligations of the Audit Commission such as accrued employment and pension rights and cost savings to
public bodies. The evaluation of cost savings, which must factor in long-term sustainability of savings through competition, will necessarily include judgement and subjectivity.

4.4 **factors to consider**

4.4.1 As stated above, a period of contractual protection is necessary to attract new entrants into the market. A transitional period, during which successful bidders, notably new entrants to the market, are partially protected from re-tendering, is necessary to create the conditions for sustainable competition. We suggest that this protection is aligned with the existing term of outsourced contracts to 2016–17.

4.4.2 A properly structured period of contractual protection should balance this incentive for new entrants to bid at competitive prices (aside from employees transferred under TUPE, they will need to invest in people, training and systems to build the expertise necessary to service a new market effectively) with mechanisms for public bodies to hold auditors to account. Coupled with the new, simplified regulatory regime, we believe service standards could be maintained or improved.

4.4.3 While it is reasonable to expect bidders to operate with the TUPE regulations in effecting the transfer of staff from the Audit Commission, the defined benefit pension scheme and certain other employment undertakings, represent a very significant barrier to many bidders. Unless addressed these barriers will significantly reduce the number and value of bids. We would, therefore, urge Government to structure a disposal process such that the employment terms of transferring staff are as closely aligned to private sector practice as is possible. This would entail the Government retaining the accrued pension liabilities and certain other obligations (for example excessive redundancy packages) as it plans to do in relation to the privatisation of Royal Mail through the Postal Services Bill. We would further suggest that the long-term funding risks of these accrued liabilities would be funded more cost effectively by Government than by bidders. Consequently, long-term value is most likely to be delivered by the Government structuring the disposal so as to retain these liabilities.

4.4.4 Allowing each (larger) local public body to procure its own auditors does create a risk that the audits of some (smaller) bodies, by virtue of their size and or geography, prove to be unattractive to the market as individual contracts. Currently such audits are bundled with larger audits. Small bodies may, therefore, attract few bids and or find their audit fees significantly higher than the current scale fees. Collaborative procurements, which local authorities are experienced in for other services, may mitigate this to some extent, but ensuring that all local public bodies are able to benefit from the reform of the market should be a fundamental requirement of the way in which any competition process is structured.

4.4.5 We believe that a panel of approved auditors should be established by means of a framework or similar arrangement. The purpose of such a panel (or panels if Local Government and NHS needs vary significantly) should primarily be to facilitate cost effective access to audit firms deemed fit by the relevant regulator. Panel membership would necessarily be broad and perhaps split regionally. Use of such a panel should not be mandatory, but provide a route to reduce the costs of procurement and take advantage of Government purchasing power.

4.4.6 An employee mutual will initially be less diversified than other market participants by virtue of solely supplying the public body audit market reporting to a single year-end. A potential solution is the creation of a strategic alliance or partnership with a third party. This could provide financing, management, back-office systems, but also share staff to service different markets and improve utilisation of resources. The viability of an employee mutual would therefore need to be assessed carefully in the context of any such strategic arrangements proposed.

*Philip Rince*
BDO LLP

**Summary**

1.1 MacIntyre Hudson is a top 20 firm of Chartered Accountants and in 2010 formed MHA, a group of associated major regional firms to provide nationwide coverage. We are making this submission on behalf of MHA. Our member firms carry out work for the Welsh Assembly and the Scottish Parliament. We are one of the leading firms of auditors in respect of FE Colleges in the UK and we are committed to extend our business to include Councils, Police, Fire and Rescue authorities and NHS Trusts. In addition to external audit, we provide internal audit services, which invariably involve value for money reviews.

1.2 We recognise that the Audit Commission provides a quality service and this is reflected in the latest report of the National Audit Office:

“We considered the Commissions’ financial reporting is effective, transparent and of high quality.”
The transfer of the work of the Audit Commission should, in our opinion, be based on obtaining value for money with firms competing for the work whilst retaining high quality, with a system of monitoring the work of auditors.

1.3 There are currently five private firms of auditors contracted with the Audit Commission in respect of approximately 30% of the work. Press reports have suggested that 100’s of firms should carry out the work of the Audit Commission. The Audit Commission is appointed to 900 principal authorities and NHS Trusts. It is our opinion that these 900 bodies should not have 100’s of firms of auditors. It is important that appointed firms:

— Have sufficient number of appointments to enable them to invest in training and development, and recruit a significant team of specialist staff.
— Are able to demonstrate relevant expertise.

Principal bodies should not have auditors that deal with a small number of relevant audits. Those auditors will not be able to invest in relevant training, and will struggle to provide the level of technical back-up. Nevertheless it is important that there are sufficient numbers of audit firms dealing with Principal Bodies to ensure there is competition in the market.

1.4 The Audit Commission carries out many functions:

— Regulator and Standard Setting; setting work specification and monitoring the performance of auditors.
— Manager of the system; allocating work to auditors including the Audit Commission’s own team; setting fee levels, deciding standard fee levels across the board irrespective of the underlying cost.
— Auditor.
— Technical Support.
— Numerous other assignments including comparison of performance of Principal Bodies; Annual Fraud Survey together with a substantial number of other reports.

It is probably unique in having one body acting as Regulator; Manager of the system and Auditor.

We will consider the options available in respect of the Audit and Regulatory functions of the Audit Commission and we believe these are as follows:

1.4.1 Retain the Audit Commission in its present form—The Government appears to have decided this is not an option.
1.4.2 Require the Audit Commission to regulate the work of firms it contracts with.
1.4.3 Transfer work to private firms and rely on their Institutes and regulators.
1.4.4 Transfer part of the Audit Commission work to an MBO of the Audit Commission staff.

It appears from Press Reports that the main reason The Government has decided not to retain the Audit Commission in its present form is cost. In its current form Principal Bodies are effectively required to meet the cost of the services whatever that cost may be. Local Councils can only go to the Audit Commission and the Audit Commission decide who does the work.

The Audit Commission set a scale of fees and a schedule of hourly rates. London Partner rates for 09 10 were £380 and Manager rates £210. Rates set for 09 10 for a unitary council or county council were £135,000, although our experience from a review of accounts is that fees are normally higher than the rates quoted. These rates appear high to us but this may be because of a policy of pooling costs to cover work that the Audit Commission undertakes where there is either no fee or an uneconomic fee. It appears that fees payable to auditors are often higher than the figures quoted because of additional work. Due to the fact that there is no competition in the market, Councils have to accept the cost and have no room to negotiate fees. In our opinion costs to Principal Bodies will only reduce if there is a free market with sufficient number of participants.

In the year ended 31 March 2010 the staff pension scheme deficit of the Audit Commission increased by £103 million. This is an issue that would have to be addressed if the work was transferred to the private sector. Private sector firms are unlikely to take on the open-ended liability of a final salary pension scheme. They would only take on staff with a defined contributions scheme and the government would have to retain liability for employees’ rights to the final salary scheme.

We believe the Audit Commission could have a role as a regulator. However, private audit practices are currently subject to their own form of regulation and if the Audit Commission was a regulator for PBI’s this would add another layer of bureaucracy that would require funding. In our opinion one system of regulation for private and public sector audits would be more efficient and reduce costs. The obvious choice of regulator in our opinion is ICAEW and CIPFA and we believe the two should work together.

Throughout the UK private Companies, Charities, Colleges etc are all subject to audit by private firms of auditors. It is a natural extension to carry out the audits of public bodies. This would however require the private firms to recruit Audit Commission staff to provide continuity and relevant expertise.

An alternative is to transfer part of the Audit Commission work to an MBO team. They would have the relevant expertise. The disadvantage the MBO team would have is that they would rely solely on public sector work. Their competitors would have a broad range of clients. The year ends of all the MBO team clients would
be 31 March, making all their work seasonal. Their clients would be open to attack by the independent firms. An MBO is likely to be more practical on a regional basis; it would be difficult to cover the whole of the UK. The London area is an obvious target for an MBO. We suspect that an MBO would be taken over by a larger practice within a relatively short timescale, and this would result in one firm dealing with a significant percentage of the market.

There is a danger that the big four firms end up with most of the work, and when they have cornered the market, it is likely that prices will rise. Historically there were 13 private firms with 15% of the market and today there are five firms including three big four firms with 30% of the market. Our reading of the Audit Commission papers is that they want to ensure that the firms that carry out the audit work have the right quality and expertise and they have therefore selected larger firms. It is important that the balance is right, and that there are sufficient firms with relevant experience and sufficient appointments to have a viable part of their business in the audit and assessment of local authorities. We believe that organisations of our size are well placed to provide a cost-effective and personal service. We would draw a parallel with the launch of the Further Education sector in 1991. In the beginning, the audit of the newly formed FE corporations was very much the domain of the big 4, and whilst there was not a specific steer in that direction from the regulator, it was very much a managed market.

Our references above are in respect of the audit of Principal Bodies. There are in the region of 9,800 small bodies with income expenditure below £1 million and of these 7,600 have income expenditure below £50,000. In our opinion these bodies should be exempt from external audit and subject to independent examination along the lines of charities with the bodies between £50,000 and £1 million also being subject to internal audit.

THE WORK CARRIED OUT BY THE AUDIT COMMISSION

2.1 The Audit Commission work includes:
- Audit
- Assessment
- Research
- Data-matching

The audit of the accounts of local authorities and other public bodies has differences with audits typically undertaken in the private sector.

The audit includes an independent opinion on the financial statements, and that is in line with the typical work in the private sector. Audit assurance represents a significant part of our core business.

In the public sector the scope of the auditors work is extended to cover arrangements for securing economy, efficiency and effectiveness in its use of resources. We have significant experience of this type of work through our internal audit service.

The public sector also includes the scope of legality and probity propriety. The certification of claims and returns is also an important area of work. It will be necessary to transfer Audit Commission staff with relevant experience to private firms; however there are parallels in respect of this work in the private sector and the merger of staff with different skill sets working together as a team will in our opinion produce the best results. We have extensive experience of conducting regularity (probity and propriety audits under the Nolan principles) audits in FE.

Due to the very nature of our structure and training, our staff have exposure to both external audit, internal audit and a VFM focus.

There are areas in respect of the scope of Auditors work that the legislators should consider, for example the right of the public to ask questions of Auditors. It appears to us that questions put forward by members of the public should be directed to elected representatives and not Auditors.

We believe that medium sized firms with nationwide coverage offer the blend of skills required to deliver work currently carried out by the Audit Commission and this can be achieved with the costs savings that are being sought by the government.

It is important that the scope of the public sector audit is not lost in any transfer of audit responsibilities to the private sector.

We believe that the transfer of Audit Commission staff is key to the transfer of relevant knowledge and experience, and we would seek to recruit Audit Commission staff.

2.2 There are a number of initiatives that the Audit Commission has been responsible for in recent years. Some that can easily be identified as part of their responsibility and others where the link appears tenuous.
A good example of an initiative that can easily be recognised as relevant is the National Fraud Initiative. The question arises how this will be dealt with in future? Will it be organised by the National Audit Office? Will it be scrapped? We believe it is a valuable exercise and should be retained.

The Audit Commission has statutory duties to report on value for money in the application of government legislation on local authorities. The Audit Commission has spread its net widely and we question if some studies are about value for money.

With the transfer of the Audit Commission responsibilities to the private sector, these initiatives are likely to be lost and that will undoubtedly be part of the cost saving. The Government will have to decide if it requires such studies to be undertaken, and if so how they will be carried out. In our opinion it should be managed by the NAO with the work contracted out as they decide.

2.3 Research and data-matching will undoubtedly be carried out by some private firms and this will be used as part of their marketing and practice promotion, but the level of this work is likely to reduce. A decision needs to be taken how this service will be provided and in our opinion it should be managed by the NAO and contracted out as they decide.

Timing

We consider that the timing of any transfer of responsibility to the private sector is an important consideration. A delay in the decision to implement any transfer will have a negative impact on the morale of the staff, and it is likely that key staff will move as the opportunity arises, resulting in a reduced level of service and a fundamental shift in the dynamics of where resources will be available.

We appreciate that any transfer should be made at the time the audit for the year is complete, and before any significant work is carried out for the following year.

At the same time relevant legislation has to be in place to deal with a new system, and that will take time to implement.

Current contracts with the five private sector firms are in place until 2016–17 and we assume that they will not be changed although they will need to reflect changes in legislation.

Future Contracts

We believe that future contracts should be between the Auditors and the Principal Body with the decision in respect of the appointment being made by the full Council. The recommendation being made by the relevant officer and the Audit Committee.

We believe however that the NAO should have a power of veto and there should be an appointment process with all proposed appointments being notified to the NAO in advance. The power of veto should be limited to specific points including the restriction of any one firm being allowed to obtain more than 10% of the market.

There should be written into the contracts that in the event of change in control of the auditor, the appointment would have to be ratified with the approval of the NAO.

Code of Practice and Technical Support

The Audit Commission is responsible for issuing the Audit Code of Practice for Local Government Bodies and for NHS Bodies and this is approved by Parliament. We believe this responsibility should be passed to the new Regulatory Body and approved by the NAO every five years. We consider that the regulatory body should be the profession—that is the ICAEW and CIPFA, working together.

We consider that audit firms will provide their own internal technical support and this should be backed by support from the profession that is the ICAEW and CIPFA. We have been part of the working party producing the Audit Code of Practice in FE.

Structure of the Future Profession

Fees charged for audit and assessment to AIBs in 2009–10 totalled £182.7 million with 30% being dealt with by five private firms. This would suggest that the Audit Commission had fees for audit assessment by their own staff of £128 million. The objective of passing the work to the private sector must be to reduce those fees, and it is reasonable to assume that the target would be to reduce to something in the region of £100 million.

It would not make sense to transfer this work to 200 firms at an average of £500,000 per firm. There would be insufficient scale of activity in each firm to deal with the work effectively.

On the other hand, if the fees were split into four blocks of £25 million, there would not be competition.
It is our opinion that the fees should be split into blocks of £5 million to ensure there is sufficient competition in the market. No single firm should be allowed to control more than 10% of the market. This would need to be overseen by a body such as the NAO.

Head of Public Practice
MacIntyre Hudson LLP

Chairman
MHA

Written evidence submitted by ACCA

ACCA is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA has 140,000 members and 404,000 students in 170 countries, and works to help them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of over 80 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; pensions; education; and corporate governance and corporate social responsibility.

Executive Summary

The Association of Chartered Certified Accountants (ACCA) welcomes the opportunity to respond to the call for evidence by the Communities and Local Government Parliamentary Select Committee for its Inquiry on audit and inspection in local government.

— We believe that there are a number of issues and outstanding questions that need addressing if local government is to have a sensible, proportionate and cost effective auditing system for local public services in the future—this is tantamount to ensuring accountability and the stewardship of public funds.

— The disentanglement of the current audit regime has come at a time when public services are undergoing radical change and restructuring which necessitates strong governance, risk management and audit. We are concerned that if Government proposals are not fully thought through that we will have a mish mash of auditors and regulators for public services that fail to deliver both accountability and cost effectiveness for the public.

— The abolition of the Audit Commission coupled with the abolition of the ethical standards regime for local government places governance and accountability of public services at risk. Also, as health bodies are undergoing major change it is still unclear how the audit of health services such as the new GP consortia will be delivered.

— If the Government intends local authorities to appoint their own auditors by 2012, not only has the legislative process to be put in place, but it has no means of knowing how the audit market will react. There continues to be uncertainty about how value for money will be dealt with and how anti-fraud and corruption measures will be addressed. Not least there are questions over whether the new audit arrangements will be cost effective for local government in the long-run. We have set out a number of issues below that we hope will be considered as part of this Inquiry.

Auditor Independence

Overall, we are supportive of a mix of firms and the current proposal to establish a new audit mutual made up of what was the district audit service competing for local government audits. We also are keen to ensure that safeguards are introduced to ensure that small and medium sized accountancy bodies are not crowded out from competing for audits by the “Big Four”. In our response to the European Commission’s Green Paper, we outlined that a market with greater competition and choice would be in the public interest and regulators should intervene, if only, to create a level playing field.

History tells us that as far back as the 19th Century for a considerable period of time auditors which were appointed and locally elected were largely ineffectual and there was no evidence to show that local authorities (poor boards as they were then) improved or tackled fraud and corruption. Because of this in 1868 Parliament

49 http: www.accaglobal.com documents cdr991.pdf
took the decision to ensure that auditors were completely independent of those they audit. This model of independent appointments has largely remained unchanged for 150 years and has meant that auditors could go about their work without fear or favour. This has been one of the fundamental principles of public audit.

As a result of these arrangements even today the public sector does not have the same issues of auditor independence as in the private sector, where, arguably company management exerts more influence than the shareholders on the process of selecting and appointing auditors, a situation which could compromise independence by allowing cosy relationships to develop in fear perhaps of losing business. The recent banking crisis shone a light on these issues with particular reference to the balance of audit to non-audit work offered by firms which has the potential to compromise auditor independence.

As yet it has not been made clear as to who will be appointing the auditors in a typical local authority. This raises a number of questions. If one follows the private sector model where shareholders appoint the company auditors, then it would be local tax-payers or residents who would be responsible for appointing the auditors and setting terms of reference. Also, given that central government funds 75% of local authority expenditure it would seem logical that it would have a say.

Current government thinking is that the full council would make the appointment. However, this in itself could lead to problems, particularly in relation to public perception and trust. Arguably, the full council of a local authority has a democratic mandate on behalf of the public to make the appointment, but where will be the safeguards to ensure that the ruling political party has not exerted undue influence over the decision? It can’t be in the public interest to have those responsible for decision-making also influencing the choice of auditor and setting their terms of appointment. This arrangement would need to have checks and balances to avoid conflicts of interest arising. Again, current thinking is that local authority audit committees would fulfil this role.

We believe that strong audit committees are fundamental to strong corporate governance, but there are a number of issues that will need to be overcome if local government audit committees are to take on this role. Firstly, not all local authorities have audit committees and there is no statutory duty for them to have one. In comparison, in a growing number of countries audit committees are being mandated for listed companies. Secondly, audit committees will have to be strengthened in terms of skills, expertise and capacity to take on this new role and at further expense to local authorities.

In our view and experience of the private sector, the oversight role of the audit committee will continue to expand and grow. In relation to local authorities, audit committees will need to be mandated and strengthened by drawing upon all available sources of expertise, including internal audit functions, external auditors, and, if necessary, outside lawyers and advisors. This means ensuring that knowledgeable and independent-minded individuals are appointed to local authority audit committees and that they develop an aptitude for asking the right questions to prevent conflicts of interest arising.

The Relationship between the Provision of External Audit and other Non-audit Services

Related to auditor independence is the extent to which audit firms will be able to perform non-audit services (consultancy) and or provide internal audit services for authorities in the future. Arguably, as shown in the private sector it has compromised the auditor’s obligation to carry out an audit fearlessly and independently. For example, most recently, MPs have raised concerns about the mix and provision of non-audit services in their review of the banking crisis.

Given that local public services are exposed to wider audit coverage (financial, governance and VFM) than their private sector counterpart there has been little need to provide consultancy or advisory services outside the scope of the audit. However, what is still unclear is whether or not the wider audit remit set out in the Audit Commission’s Code of Audit Practice will be restricted in scope and if so whether this will increase consultancy.

As it currently stands the Audit Commission monitors consultancy work carried out by a firm that is providing an external audit service so that it does not compromise auditor independence. Consultancy contracts can be more lucrative and strategically important to the firms than individual audits and we believe that checks and balances need to be introduced to prevent conflicts of interest arising. Similarly, it is not clear what will prevent a firm providing both external audit and internal audit services to the same local authority. Most recently, questions have been raised where the external auditor of a UK listed companies has carried out internal audit work for the same client. In 2010 the Financial Reporting Council (FRC) made a decision to carry out a review of “extended assurance services”. The review is currently in progress.

Implications for Value for Money Reporting

We understand that the Government proposes that the Audit Commission’s value for money work will pass to the National Audit Office (NAO) and discussions are currently underway about how this could work. Whilst
the NAO has an excellent record of value for money with central government departments, NDPBs and agencies, it has no track record of value for money in local authorities. There are a number of issues that arise from this potential arrangement.

Firstly, if local authority VFM reporting becomes a function of the NAO it will require additional resources and will need to build the necessary capacity and skills to undertake the work. In other words it will cost more. There will also need to be arrangements put in place for it to liaise with the firm carrying out local audits. The House of Commons Public Accounts Committee (PAC) workload is already at stretching point with on average of 70 VFM reports being reviewed each year. In our view it hasn’t got the time or capacity to follow up existing VFM reports so it is questionable how it will deal with the additional VFM workload without having to consider other mechanisms for reviewing VFM reports as part of the Parliamentary process.

Secondly, if it is the case that VFM reports on local authorities are undertaken by the NAO, then it is not unreasonable to think that one day a local authority chief executive will appear before PAC. This doesn’t quite fit in with the localism agenda and muddies the waters in relation to accountability. John Tiner in his review of the NAO’s governance arrangements pointed out that the “constitutional background and lines of accountability for the audit of central government and local government are, properly, quite different and could become unclear if one body is responsible for both”. It is not clear how this concern will be taken on board in the new arrangements.

Thirdly, and perhaps most importantly, because of the Audit Commission’s “arms length” position it was able to comment on government policy when that policy was failing (irrespective of the government in power) and was able to criticise authorities if policy was being badly implemented by them. A key difference between the Audit Commission and the NAO is that the Auditor General does not have the authority to comment on government policy. The move of local authority VFM reporting to the NAO may seem a natural one, but this will take away one level of accountability—the scrutiny of policy for local authorities.

Benchmarking and identifying good practice was an important aspect of the Audit Commission’s VFM studies and is highly regarded across public services. We acknowledge that there are other organisations such as the Improvement and Development Agency, CIPFA etc. which provide similar data and benchmarking services, however, it needs highlighting that the reason the Audit Commission’s benchmarking data was held in such high esteem was that, unlike other data, it was independently audited. We already know that the public and stakeholders have more confidence in data which has been independently verified.

**The Regulation of Audit**

Historically, the procedure for setting the audit fee is different between the private and public sectors. The pricing structure for performing an audit is generally criticised for potentially compromising the quality of an audit in the private sector and used as a political football in the public sector. In the private sector, authority to agree the auditor’s fees is invariably delegated by the shareholders to the directors. In the public sector, fees are at present determined by the audit bodies that regulate the sector.

Currently the Audit Commission sets the audit fee for local authorities: both private firms and the Commission’s auditors adhere to this benchmark. They cannot charge whatever they want without full consultation. Arguably, this process has resulted in low audit fees across the sector. Now that this process will be dispensed with, a key question is whether market competition will inevitably result in lower audit fees for the public sector as a whole. One only needs to look as far as a study conducted by the London School of Economics (LSE) in 2002 which highlighted a hike in audit fees following the reduction from five large firms to four. According to the LSE audit fees increased by 2.4% and have continued to grow since then. Arguably, the Audit Commission has had a successful record in regulating fees so without such regulation our concern is what is to stop a hike in audit fees for local public services without some form of regulator such as the NAO stepping in.

In the absence of comprehensive research in this area we would suggest that the impact of any new proposals and levels of audit fees across public services are monitored. We understand that 410 local authorities will be tendering for auditors, notwithstanding fire and police authorities and health bodies. This would inevitably mean that costs are involved.

Safeguards will also be needed to ensure where there is no ready audit market because it is not of strategic interest or profitable for the firm that the gap will be filled. Also, cherry picking of local authorities will need to be addressed. For example, if a local authority is performing poorly it will be less likely that a firm would want to undertake the audit because of the risk and costs involved. It would be more preferable to go for a high performing authority without the risks.

**Implications for the Auditor’s Liability**

Until recently the auditing profession in the private sector has resisted the idea of extending the scope of the audit. It has been concerned that doing so would increase the exposure of the auditor to what is already a substantial liability. This gives rise to two concerns. Firstly, there is a wider scope of audit in the private sector so firms will have to take out additional insurance which will inevitably impact on the size of the fee envelope

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and secondly, although the public sector is considered to be less litigious than the private sector, this may well not be necessarily the case in the future. Firms will be more than aware of the potential risks posed following the Westminster “homes for votes” scandal and a catalogue of failure and judicial reviews. The new arrangements could have the potential in creating a more litigious environment across local public services.

In the public sector, there are more complex relationships between the Audit Commission, its auditors and public bodies than in the private sector. Appointed auditors are required to discharge their statutory and other responsibilities, and to exercise their professional judgement independently of the Audit Commission and its officers, and of the audited body. These decisions can only be challenged in court. The Audit Commission indemnifies its auditors against any charges, losses and expenses should legal proceedings be taken against them. The loss of the Audit Commission will mean that firms will have to take out additional indemnity insurance which will have to be reflected in the price of the audit. It is not yet clear how this will be addressed in the new arrangements to minimise the cost of the audit.

**Anti Fraud and Corruption Work**

It is not clear what will happen to the Audit Commission’s anti fraud and corruption work. One suggestion was to move it across to the National Fraud Authority (NFA) although this has not been confirmed. In the light of the abolition of the Audit Commission this may well be the most appropriate place given that the Chairman of the Fraud Advisory Panel, an independent fraud watchdog, has called upon government and businesses to develop a more consistent approach to combating fraud which costs the UK around £30 billion a year. However, there are outstanding issues to resolve such as resourcing, capacity building and sorting out data sharing and whistle blowing arrangements between the audit bodies, firms and NAO to ensure that additional responsibility and ensuring initiatives such as the national fraud initiative (NFI) which has helped trace £646 million of fraud and error payments since it was established are not lost.

**Power to Intervene in Cases of Emergency**

What has not been clearly set out by the Government is whether or not there will be some form of regulatory function body such as “Monitor” for foundation trust hospitals which will have the powers to intervene where there are severe operational failings or in aspects of its leadership. It has not been made clear by the Government whether this responsibility will pass to the NAO or will remain with the home government department. We would like to see some clarity on the form of regulatory process to be put in place.

**Reporting in the Public Interest**

It was recently clarified by the Minister for the Department of Communities and Local Government at a House of Commons Communities select committee that auditors will be expected to report in the public interest where there are serious failing. This in our view is an important part of ensuring accountability and sound stewardship of public funds. However, it hasn’t been outlined how a number of issues will be addressed—for example, the potential impact on the audit fee resulting from a complex public interest matter and how public interest reports will be co-ordinated for shared services and or partnerships where multiple audit firms are employed.

**Where will the Auditors be Able to Look for Guidance and Support?**

When significant and common issues across authorities arise such as councils combining together not to set a rate or deal in rate interest rate swaps, how will the response be co-ordinated amongst firms, if at all? Previous experience has shown that these issues were successfully tackled because of combined resources, support and guidance. If the plan is to leave it to each individual firm to their own devices not only will this increase cost, but ultimately the audit fee. Most importantly it may lead to an inconsistent audit response and unintended consequences for the authorities and government. We believe that full consideration should be given to how and who will deliver on-going technical support and guidance, as well as setting out arrangements for co-ordination. This is an important point if audit is to continue to be responsive to common and significant issues.

**Ensuring that the Accumulated Experience of the Audit Commission is not Lost**

We acknowledge that there are a number of national bodies providing good practice and drawing out lessons learnt so that comparisons can be made. Nonetheless, in the current financial environment it would be foolhardy to suggest that these bodies will continue to provide these services without any additional resources. These bodies are suffering just as much as public services.

We are acutely aware that if the new audit and VFM arrangements are not implemented effectively both local authorities and the government will lose the capacity to address “wicked issues” across services and between services, capture comparisons and benchmarks to drive up standards and ensure the overall economy, efficiency and effectiveness of public services. We would like assurance that the infrastructure to capture good practice and lessons learnt is not lost in the new audit framework being developed.

*January*
Written evidence submitted by the Chartered Institute of Public Finance and Accountancy  C PFA

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world’s only professional accountancy body to specialise in public services, CIPFA’s portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

EXECUTIVE SUMMARY

— Audit and inspection of local authorities has a critical role to play in ensuring that those responsible for handling public money are held fully accountable for its use.
— Public audit currently involves provision of an opinion on public bodies’ financial statements, and also provides assurance on wider issues including regularity, propriety and value for money (VFM).
— CIPFA believes that the three principles of public audit should continue to be central to the Government’s new audit and inspection regime for local authorities: wide audit scope; ability of the auditors to make the results of their audits publicly available; and independence of public audit from the organisations being audited.
— Even if the National Audit Office undertakes high level VFM studies as it already does in the NHS, this approach will not provide the more complete data required to identify widespread problems at an early stage along with potential solutions.
— Auditors will in future be in the “front line” without the Audit Commission standing behind them in both technical support and liability terms. This could either lead to a reduction in the frequency or increase in the cost of public interest reports and other similar work. New arrangements should be stress-tested to ensure that they are sufficiently robust to manage the pressures which accompany the most difficult cases which arise perhaps once in a decade.
— To demonstrate an appropriate degree of independence, a locally based appointment process would potentially require prescription of significant reform of local authority audit committees.
— Central decisions will be required, balancing costs and risks, on the principle of whether any limitation of auditor liability will be acceptable in future and, if so, on what basis.
— Standard appointment terms will be needed to maintain consistency of approach to the audit of public money, and to avoid the need for the same issues to be addressed multiple times across local government.
— To maintain the quality of local public audits, audit suppliers need to demonstrate a different and broader range of skills and knowledge than for commercial audits. There needs to be a proportionate quality assurance regime, and authoritative technical guidance to ensure that novel issues are addressed consistently. Arrangements for dealing with enquiries and complaints from the public in relation to local auditors must also be specified clearly.
— The complexity of the continually evolving interplay between local government finance and professional accounting and auditing guidance means that a Code of Audit Practice and supplementary guidance and support will continue to be required. It will be important to be clear about the allocation of responsibility for these functions and about funding arrangements.
— In the absence of the Audit Commission’s unified national pricing framework, the cost of audit services is likely to vary from council to council. Larger public bodies are likely to be particularly attractive clients, and this will be reflected in fee proposals. Smaller and more remote councils will be less attractive audits. Safety net arrangements are likely to be required to ensure that such audits can be procured at a reasonable cost.
— Downward pressure on prices is more likely to be maintained if District Audit remains an independent specialist practice rather than being taken over by a firm. The vehicle adopted and the approach and timetable for deregulation of appointments will have a crucial influence on both its stability and timing.
— The abolition of the Audit Commission, the major NHS reforms and the creation of academies present an opportunity to develop a pan public service approach to public audit which enhances public accountability.
INTRODUCTION

1. In a paper entitled, "e rin i es i dit" published in 1998, the Public Audit Forum set out the three main principles which should underpin any public audit regime:
   - Wide audit scope covering the audit of financial statements, regularity, propriety and value for money (VFM).
   - Ability of the auditors to make the results of their audits publicly available.
   - Independence from the organisation being audited.

2. CIPFA believes that these three principles need to be carried forward into the new audit arrangements to replace the Audit Commission's functions. In addition we consider that two further issues must be addressed effectively in any new audit arrangements. These are:
   - Ensuring audit quality; and
   - Developing a cost-effective audit market for local public audit.

3. This submission to the Committee uses these five themes as a framework for the presentation of CIPFA's evidence.

WIDER PUBLIC AUDIT SCOPE (INCLUDING VFM)

4. The funding of public services from taxation creates a need for a different and much deeper level of accountability than applies in the private sector.

5. The public expect that those responsible for handling public money are held fully accountable for its use. This means reporting not only the amounts that have been raised in taxation and then spent, but whether this money has been spent for the purposes intended, efficiently and effectively.

6. The Government's transparency agenda and data publication initiative will certainly make local authorities more accountable at an individual transaction level but will not provide an overview of their performance at either service or authority level. Public audit will therefore remain a crucial link in the accountability chain, something the Committee on Standards in Public Life recognised in its first report:

7. The deeper level of accountability resulting from the "contract" between the public and public bodies means that public audit must not only involve provision of an opinion on financial statements, but also cover such issues as regularity, propriety and value for money. In order to discharge these obligations, public auditors must have some discretion to decide the amount of work necessary to fulfil their duties and to follow-up the implementation of their recommendations.

8. The Audit Commission has made an important contribution to improving VFM in local government not least through national VFM studies designed to find and publicise good practice. Such studies have been promoted consistently across all audited bodies by local auditors exercising their own duties to ensure VFM in individual organisations.

9. Many organisations (including CIPFA) publish best practice examples and guidelines. However, the advantage of the Audit Commission's approach has been that it could mandate auditors to follow up national studies around the country reinforcing the wide adoption of good practice. The Audit Commission has also been able to gather information centrally about what is happening locally across the country and to publish reports summarising the trends emerging. Ideally these strengths would be retained in any new arrangements.

10. Limited reviews have already replaced full-scale audits for parishes and other smaller local authority bodies. CIPFA believes that this approach is appropriate given the relatively small sums of money involved, and the potential for transparency requirements to have a significant impact in view of the relatively small number of transactions and lack of complexity in such organisations. However it may be appropriate to consider further developing those arrangements towards a model more closely aligned with the independent examination regime for smaller charities.

ABILITY TO REPORT PUBLICLY

11. For public audit to be effective, auditors must be able to make the results of their audit publicly available. Appropriate reporting arrangements are therefore required to communicate audit findings widely on a “without fear or favour” basis. This is a critical component of the accountability process.

12. Over recent years the Audit Commission has been heavily involved in inspection activities designed to facilitate reliable reporting of local authority performance. The discontinuation of these arrangements will leave a gap which councils are being encouraged to fill on their own initiative. Ideally all authorities would subscribe voluntarily to a consistent approach enabling comparisons to be made easily from one authority to another. In order to inspire public confidence in such arrangements it may be appropriate to involve independent parties in the validation of performance information and or in commenting on performance levels.
13. The abolition of the Audit Commission may have implications for some aspects of audit oversight. For example, because of the general increase in litigation in recent years, auditors have become increasingly risk averse, particularly when faced by new or contentious issues. In the run-up to the Millennium, the Government asked the Audit Commission to report on local authorities’ preparation for the risk of their IT systems being infected by the Millennium bug. Auditors were wary of doing this locally and reporting publicly for fear of giving an authority the green light only for something unexpected then to go wrong on 1 January 2000. After further discussion, the Audit Commission cut through these reservations by mandating a national study on the subject. Auditors were required to undertake audits locally, acting as agents of the Commission rather than acting in their own right. It is difficult to see how and by whom this sort of coordinated approach will be brokered in future.

14. Various special features of the local government audit regime such as auditors reporting in the public interest, dealing with electors’ questions and objections, and making applications to the court in respect of illegality, are also relevant here. Auditors have always been nervous about the prospect of challenging issues before the courts, or being in the public eye with public interest reports, where there is an increased risk of reputational damage. As auditors will in future be in the “front line” without the Audit Commission standing behind them in both technical support and liability terms, we may see either a reduction in the frequency or an increase in the cost of public interest reports. In the case of Foundation Trusts, for example, there has been a dearth of public interest reports since their creation.

Independence

15. Confidence in public audit is dependent on it being seen as independent of the organisations being audited. In addition to being able to report publicly, three further factors are likely to influence independence. These are:

- Clear and objective auditor appointment procedures.
- Demonstration of professional impartiality.
- Ability to carry out the work necessary to discharge the auditor’s obligations.

16. At the time of the Audit Commission’s creation, Government was strongly opposed to a free choice of auditor for local authorities. This led to the adoption of the current arrangements which have been managed by the Commission.

17. Any new approach in which a public body appoints its own auditor must demonstrate robustness and independence. Moreover, the financial relationship between the auditor and the audited body must not compromise the auditor’s independence.

18. In the private sector, audit committees, made up of non-executive directors, play a key role in the auditor appointment process, with the final decision being made by the company’s shareholders. This model has detractors as well as supporters. It is currently being reviewed in various studies following on from the global financial crisis. In local authorities, audit committees are made up of elected members. Elected members are clearly not independent of the authority. On the contrary they are part of the authority and contribute to both strategic and operational decision making. Significant changes would therefore need to be prescribed if audit committees were to play the central role in a credible independent process for appointment of local auditors.

19. A further question that arises is whether public bodies should be allowed to purchase other non-audit services from a company providing its audit services. This practice was heavily criticised in Parliament in the run-up to the Audit Commission’s establishment on the basis that it has the potential to compromise auditor independence. The Audit Commission have subsequently worked on the basis of a presumption against this practice in other than exceptional circumstances.

20. These concerns remain valid and to ensure that professional independence can be demonstrated consistently both on and after appointment, CIPFA believes that some form of standard audit appointment terms will be required to ensure strong and consistent professional guidance to all authorities.

21. Limitation of auditor liability was a less prominent debate when the Audit Commission was established. However, this issue will need to be fully considered as it is of critical importance in the audit profession today. The Audit Commission has shielded firms from liability. Its abolition raises important professional and cost implications for all local public audits. We believe that central decisions will be required, balancing costs and risks, on the principle of whether any limitation of liability will be acceptable in future, and if so, on what basis. This should also be addressed in the standard appointment terms, alongside other practical issues, such as appointment periods.

Ensuring Audit Quality

22. Private sector audits are generally focused solely on the provision of an audit opinion on the financial statements. The wider scope and different reporting requirements attached to public audit mean that audit suppliers need to develop and apply a broader range of skills and knowledge than for commercial audits. To maintain the quality of local public audits:

- audit suppliers need to demonstrate these skills and knowledge on appointment;
— there needs to be a proportionate quality assurance regime; and
— additional technical guidance will be required to ensure that novel issues are addressed consistently.

23. When the Audit Commission was created, a large number of accountancy firms were interested in undertaking public sector work and went through an interview process with the Audit Commission. It appointed thirteen firms and audits were allocated to them according to their relevant experience and expertise. Problems with this process emerged, however, where portfolios were too geographically diverse to allow firms to develop a strong enough skill base of people to deliver local audits of the necessary quality.

24. Subsequently the Audit Commission developed the concept of “centres of excellence” where audit appointments in a particular area were allocated to a specific office of one of the firms. This allowed the firms to recruit and retain a core of individuals to deliver audits of the right quality. The same approach was applied when market testing of audits took place.

25. If councils choose their own auditors in an uncoordinated way, there is a risk of going back to the “patchwork quilt” approach with some auditors appointed and holding just a handful of audits dotted around the country, preventing them from developing the right skills and expertise. As a minimum some form of accredited list will need to be maintained, but this then raises questions about who will manage the accreditation process, what criteria will be used, who will monitor audit quality, and how these processes will be funded.

26. Private sector audits are carried out under the frameworks set by the Financial Reporting Council (FRC) and are subject to quality control visits by either the Audit Inspection Unit (AIU) of the FRC for larger clients, or their Recognised Supervisory Body, to ensure that auditing standards and ethical requirements are being adhered to. The Audit Commission currently runs a quality control inspector process using its own staff, which would need to be replaced if local public audit quality is to be monitored in future. If the regulation of public audit was regulated by the FRC or a similar body its membership and arrangements would need to reflect the broader scope of public audit and the distinctive local government legal framework. The set up and operation of the new regime would need to be appropriately funded.

27. The statutory duties and powers of local authority auditors have always been expressed in fairly high-level terms, in order to allow professional judgements to be exercised and provide flexibility to address novel situations as they arise. Since 1972, there has been a Code of Audit Practice to supplement the requirements of the Act. Before the creation of the Audit Commission, this was a non-statutory code, and since the creation of the Commission a statutory code has been approved by Parliament at five yearly intervals. The code is necessarily high-level and is supplemented by a whole range of supplementary guidance to ensure auditors perform quality audits. These include standing guidance to auditors explaining what they must or cannot do, technical advice notes, training and helpdesk support to promote consistency and avoid the need for each auditor to “reinvent the wheel” to interpret new Acts, Government controls or new professional developments. Central support is given to auditors to help them through difficult issues that they may have had no prior experience of such as complex public interest cases, objections work and complex financial transactions such as PFI schemes.

28. As a result of the unique and specialised nature of local government finance CIPFA believes that there will be a continuing need for such a code. The opportunity should be taken, however, to review the scope and coverage of the code where appropriate to promote consistency of standards across all areas of public audit.

29. The complexity of the continually evolving interplay between the local government finance and professional accounting and auditing guidance means that supplementary guidance and support will continue to be required. Again this raises important questions about who will provide such guidance and support and how it will be funded. It will also be important to specify clear arrangements for handling public enquiries and complaints about local audit matters.

30. New arrangements should be stress-tested to ensure that they are sufficiently robust to withstand the pressures which arise in the most difficult audit cases which arise very infrequently—perhaps only once per decade.

31. There is a major opportunity presented by the coincidence of the proposed abolition of the Audit Commission, the major NHS reforms and the creation of academies to develop a pan public service approach to public audit which enhances public accountability. The need for such an integrated regime will be reinforced by the first publication of Whole of Government Accounts in 2011. It will therefore be important that the needs of the other parts of the public sector are properly taken into account in developing new arrangements for local government. This will be particularly important for the NHS given the scale of the planned reforms.

32. In developing the new arrangements, if any significant changes are proposed to the responsibilities of auditors, audited bodies, or other parties, it will be essential that these are clearly articulated, and that the cost impacts and funding implications are fully evaluated.

DEVELOPING A COST-EFFECTIVE LOCAL PUBLIC AUDIT MARKET

33. Before the creation of the Audit Commission, audit fees were paid by councils according to a specified scale relating to a council’s turnover prescribed by Government. The Audit Commission continues to prescribe a scale of fees. It did so initially by prescribing a daily rate to be charged, multiplied by the number of days
on the audit as agreed between auditor and local authority. The Audit Commission only intervened in the event of a dispute that could not be resolved locally. The fee scale subsequently was amended to set fees within specified bands.

34. If public audit for local authorities moves away from a unified national pricing system operated by the Audit Commission, there will inevitably be winners and losers. Larger and more conveniently located public bodies are likely to be particularly attractive clients, and this will be reflected in fee proposals. A solution needs to be found to avoid unaffordable fee increases for the least attractive authorities. There will also need to be some central mechanism to arbitrate where there are fee disputes that cannot be resolved locally.

35. Other questions which need to be addressed in connection with audit appointments include the maximum lengths of audit appointments, and whether all bodies must appoint their auditors independently, or whether consortia will be permitted. The Audit Commission was able to award significant blocks of work to auditors, and to guarantee appointments for five years. Firms were thus able to offer lower fees than they would have charged to clients of comparable size and complexity in the private sector making annual appointments.

36. If market disciplines are to be the main method of fee regulation, it will be critical to ensure that there are sufficient suppliers to choose from. In recent years, the number of firms undertaking large local government audits for the Audit Commission has reduced significantly following mergers. It has thus become ever more important to have the in-house audit practice, previously called District Audit, to act as another specialist auditor. There are therefore risks around both audit market concentration and completeness of coverage.

37. Downward pressure on prices is more likely to be maintained if District Audit remain an independent specialist practice rather than being taken over by a firm. There will then be questions around its stability and financing. The vehicle adopted and the approach and timetable for deregulation of audit appointments will have a crucial influence on both of these.

38. If District Audit becomes an independently run organisation outside the public sector, Government may not be able to call on it to act as the “auditor of last resort”. Some authorities may therefore face difficulties in appointing auditors at an affordable price. CIPFA believes that this issue will need to be addressed in order to ensure that all authorities continue to be subject to effective local public audit.

39. The audit of grant claims is a specific area linked to the accounts audit which requires consideration. In recent years, the audit of grant claims has been significantly pared back to cover only the larger, more risky areas. The Audit Commission has an approach for these larger grant schemes, whereby it prepares a central instruction and agrees it with the relevant government department to ensure that auditors undertake the same tests and adopt a consistent approach when giving their certificates. Ideally these arrangements would be carried forward in some way in the new regime.

Written evidence submitted by CAEW

Introduction

1. We are writing to provide evidence in response to the Communities and Local Government Committee’s inquiry. ICAEW would be pleased to provide oral evidence on any aspect of its submission.

Who we are

2. As the largest Recognised Supervisory Body (RSB) in the UK, ICAEW registers all the firms for Companies Act audit work that are currently also carrying out work for the Audit Commission and those firms likely to carry out this work in the future. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

Executive Summary

4. Devising a new local audit regime to replace the Audit Commission presents an opportunity to review the public audit and accounting regime across the public sector in England, making it more transparent and consistent with other sectors of the economy.
5. The new local audit regime should aim to avoid duplication of activity, provide economies of scale, improve accountability, strengthen financial management within local authorities and improve value for taxpayers’ money.

6. The new regime will need to consider whether the Principles of Public Audit remain relevant and if so how they will be reflected in the new arrangements.

7. One option for overseeing the new regime would be to give new responsibilities to the National Audit Office (for example in relation to the Code of Audit Practice, technical support and guidance, assessing audit firms’ eligibility to carry out the work).

8. Another option would be to create a small residuary body (for example as part of the DCLG or another suitable public body) to continue some of the key functions of the Commission.

9. An increase in the number of audit firms in the public sector audit market should not be at the expense of audit quality and the safeguarding of public money.

10. The framework for the appointment of auditors should be in line with the principles already established by independent oversight bodies and consistent with other sectors, including protection for local public bodies and audit firms.

11. Standardising the requirement for local authorities to issue annual reports and harmonising financial reporting with the private and central government sectors would improve transparency and accountability for the public and encourage other audit firms to enter the market.

12. Revising and strengthening the role of local authority audit committees would provide an independent basis for the appointment of the audit firm and the monitoring of its performance.

**Detailed Evidence**

**The principles of public Audit**

13. The Principles of Public Audit are published by the Public Audit Forum (comprising the National Audit Office, the Northern Ireland Audit Office, the Audit Commission for Local Authorities and the National Health Service in England, the Wales Audit Office and Audit Scotland). The Principles are summarised as:

- the independence of public sector auditors from the organisations being audited;
- the wide scope of public audit, that is covering the audit of financial statements, regularity (or legality), propriety (or probity) and value for money; and
- the ability of public auditors to make the results of their audits available to the public, to democratically elected representatives and other key stakeholders.

The Principles take as their starting point the assumption that the audit of public (taxpayers’) money demands safeguards that might not necessarily apply to the same extent in other sectors. In designing the local public audit regime post the Commission, consideration needs to be given to whether the Principles are still relevant and if so how they will be upheld by the new arrangements.

**Consistency across the public sector**

14. The focus for the new arrangements post the Commission appears to be on the new audit arrangements for local government; however the Commission’s current responsibilities also cover the National Health Service in England. Thought needs given as to how audit responsibilities in relation to the NHS in England will be discharged in future.

15. In particular, the Government should recognise that the demise of the Commission presents an opportunity to review the public audit and financial reporting regime across the wider public sector in England. This opportunity to create consistency across local government, health and central government audit should be considered carefully rather than the new regime being treated as a local government issue in isolation.

**Successor bodies**

16. In addition to its duties around appointing auditors of all local public bodies, the Commission has other specific statutory responsibilities. The Commission drafts the Code of Audit Practice, provides guidance and technical support to auditors, monitors audit quality, sets the grant reporting framework, is responsible for the national fraud initiative and is the public body responsible for providing information under the freedom of information legislation in relation to local public bodies.

17. All of these duties are significant and the Department for Communities and Local Government (DCLG) will need to consider carefully what happens to these responsibilities and who will take them on. This may require the transfer of some Commission costs to whichever body or bodies inherit these responsibilities. It will therefore be necessary for DCLG to consider how these bodies will be funded to enable them to take on these responsibilities.
18. Whatever new arrangements are put in place, DCLG will need to ensure successor bodies should have the following attributes:

— public sector knowledge;
— public sector audit experience;
— technical competence;
— the right infrastructure; and
— adequate resources and capacity.

19. One option would be for the National Audit Office to take on the majority of the Commission’s role (in particular in relation to the Code of Audit Practice, technical support and guidance, monitoring audit firms eligibility and independence, auditor appointments and audit quality). This would be similar to the arrangements which already exist within Wales (by the Wales Audit Office) and Scotland (by Audit Scotland). The NAO contracts some of its work to audit firms already in the local public audit market. This arrangement would avoid duplication; provide economies of scale and would be cost-effective as the NAO already has the necessary public sector audit experience and expertise in place.

20. Where there are specific skill gaps with respect to local audit, the NAO could recruit or receive by transfer key Commission staff with relevant expertise. Another factor which makes this a viable option is that the NAO will be the body responsible for auditing the Whole of Government Accounts (WGA). Local government accounts will be consolidated into the WGA of which the NAO is the external auditor. WGA will be published for the first time for the financial year ending 31 March 2010.

21. Another option would be to create a small residuary body (either as part of the DCLG or another suitable public body) to continue some of the key functions of the Commission. Key aspects of the public audit regime such as audit appointments, independence, audit fees, public interest reports etc. could be discharged by this small central body. This would avoid the possibility of several successor bodies sharing the Commission’s different responsibilities, avoiding potential duplication and increased costs.

Audit quality and increased market participation

22. ICAEW is in favour of increasing market participation in the public sector audit market. However, any policy objective to increase market participation should not be at the expense of audit quality and the safeguarding of public money. While potential new entrant firms to the public audit market will already have quality control systems in place for audit work in other sectors, not all audit firms will have the necessary public sector experience and building up such experience will take time.

Owner and duties and impact on audit fees

23. The current powers and duties of auditors in the public sector are included in a framework document published by the Commission, which plays a key role in keeping audit fees at a controlled level across the local public audit market. There is no evidence to suggest that under the new regime, giving local bodies the power to appoint their own auditors will necessarily result in a reduction in audit fees paid by individual bodies.

24. If the government is seeking to reduce the overall level of audit fees, it could take the opportunity to consider the current powers and duties of auditors and bring about some consistency in the audit framework between central government, health and local government. It would not, in our view, be sensible to introduce new duties (see paragraph 26) or retain existing powers or duties within local audit (such as public interest reports and inspection of accounts by electors, see paragraphs 28 and 29), which are not mirrored in central government or NHS audit. The more consistency there is between the different parts of the public sector in England, the easier it will be for audit firms to transfer their expertise between the different sectors and achieve economies of scale for the tax-payer.

25. Currently the Commission provides support, in specific circumstances, in terms of guidance, legal advice and indemnity cover for all its appointed auditors. A new framework will need to consider whether such support will remain available to auditors and who will provide it. There will also need to be a minimum amount of support available to auditors new to the market under the new arrangements.

Audit scope, risk and impact on fees

26. It has been suggested that the scope of local public audit could in future require a separate audit opinion for each of the four categories of audit work mentioned in the Principles of Public Audit (see paragraph 13). Not only would this impose on local authority audit a requirement not present in other parts of the public sector in England, but any increase in audit scope will result in audit firms taking on additional risks which would be reflected in the fees charged.

27. The higher the audit risk of a client, the higher the audit firm’s potential liabilities in relation to that audit client. In order to mitigate the higher risks and increased potential liabilities, the audit firm is likely to need to increase its insurance cover (as insurance companies will not provide cover at the same level without
the benefit of the Commission providing support). This will likely lead to an increase in audit fees, as auditors will need to recover their costs in some way for agreeing to take on an increased scope of audit.

**Public interest reports and inspection of accounts**

28. Public interest reports are unique to local authority audit in the English public sector. They are produced by the auditor where there are grounds for believing, for example, that an authority has wasted significant amounts of public money through mismanagement or worse. The publication of such reports inevitably brings the auditor into conflict with the audited body. We are concerned that without the protection of the Commission (which currently reinforces the auditor’s independence, meets the costs, provides the guidance and support and indemnifies the legal costs that may arise) or a similar residuary body, auditors may be put under pressure not to report in the public interest. There is potential that an auditor’s independence could be compromised through the contractual relationship, perhaps with the audited body being unwilling to pay the fees or threatening termination of the contract.

29. Local authorities are again unique in the English public sector for by law allowing local electors to inspect the annual accounts and to raise questions and objections with the auditor. The ability of the auditor to decline to receive such questions and objections is very limited. The result is that much audit time and cost can be expended researching and answering issues raised by electors. Given the greater transparency of spending now available through publication on line of significant local authority expenditure items, a review of whether this unique situation should continue is advisable.

**Independent appointment of auditors**

30. There are a number of aspects to the independent appointment of auditors in the public sector, which ICAEW has concerns about.

**Eligibility criteria**

31. The eligibility criteria for firms wishing to conduct public audit need to ensure that only competent auditors with the appropriate knowledge, skills and experience are appointed. However, there needs to be a mechanism in place to enable new firms wishing to enter the market the opportunity to gain the appropriate knowledge, skills and experience.

**Power of electorate to veto appointment**

32. ICAEW is not in favour of the power of the electorate to veto the appointment of auditors, which would be unique to local authority audit across the public sector in England. In our view, this could be counter-productive and expensive to the whole appointment process and could result in an authority wasting valuable time and resources going through a re-tender process. In our view, the audit appointment should be made by the full council on recommendation from the audit committee.

**Mandatory rotation of auditors**

33. The Commission, under the current regime, appoints auditors (to local and health bodies) for a fixed period and upon re-appointment may appoint the same firm with a change of lead partner. This is in line with the Auditing Practices Board’s ethical standards. There have been discussions on the benefits of mandatory rotation of local authority auditors with the suggestion that (to further reinforce independence) the audit appointment should be limited to two, three or five year appointments with a change of audit firm after a fixed period.

34. In our view, the looked for benefits of mandatory rotation need to be weighed against the disbenefits. Mandatory rotation of the whole audit firm has been tried in other jurisdictions but has not been a success. We are only aware of one G20 economy which requires mandatory firm rotation on a continuing basis. The key problems of mandatory rotation are:

- rotation of auditor firms for short periods may decrease audit quality, because although the appearance of independence is very important, knowledge of the organisation is critical to quality;
- it erases the cumulative knowledge of an audit firm and thereby reduces audit effectiveness and efficiency and increases costs to organisations; and
- it can be used as an excuse to undermine audit quality by allowing issues to be hidden after a rotation.

35. The risk of over-familiarity is a valid concern, as is the threat of complacency if a competitive tendering process is not on the horizon. However, the value of experience and transfer of knowledge must also be acknowledged. If a good audit committee is in place, it will keep the choice of auditor, and the performance and objectivity of the incumbent, under constant review and should be willing, when it sees fit, to conduct a fresh tender. In the private sector, ICAEW has stated that there should be mandatory rotation of audit partner at least every seven years for public interest entities, as required by the Statutory Audit Directive. We believe
that this achieves an appropriate balance in the regulatory framework between the necessity of renewal and the benefits of continuity.

36. The Statutory Audit Directive requirement mirrors the Code of Ethics issued by the International Ethics Standards Board for Accountants (IESBA) under the oversight of the independent Public Interest Oversight Board (PIOB). The Code mandates the rotation of key audit partners on public interest audits at least every seven years to protect against over-familiarity and requires potential threats due to over-familiarity to be considered for all other audits. We are not aware of a jurisdiction in which a partner rotation period of less than five years has been deemed appropriate.

37. ICAEW’s view, therefore, is that we should be consistent with the framework promulgated by independent international oversight bodies and should not introduce a different framework solely for local public audit. It would be inconsistent if mandatory rotation was brought into local government in England, but there was nothing similar in health, central government or indeed the private sector.

38. In considering all of the above, both parties should have the right to terminate the relationship if it is felt to be unsatisfactory with appropriate safeguards.

39. Currently the Commission reviews the quality of audits of local public bodies by contracting with the Audit Inspection Unit (AIU) of the Financial Reporting Council. A similar arrangement could be envisaged post the Commission, however in the private sector the remit of the AIU is restricted to public interest entities (basically companies with a market listing). A review of whether the AIU should be responsible for monitoring the quality of all local public audits would be appropriate.

40. Giving a new responsibility to Recognised Supervisory Bodies (RSBs) to register audit firms for public audit should be considered. Currently, the Audit Registration Committees of the RSBs only register auditors and responsible individuals for the purpose of Companies Act audits. There is no equivalent provision for public sector audits. Thus, the RSBs do not recognise public sector audit work under the registration and therefore do not license auditors separately for public sector audit work. There would need to be a legislative provision for the Audit Registration Committees of the RSBs to take on this additional role. However, it would seem inconsistent for there to be a requirement for audit firms to be registered for the audit of local public bodies without there being an equivalent requirement for the audit of National Health Service bodies, central government bodies and agencies.

41. There are a number of aspects in relation to the possible new framework that need to be thought through carefully before decisions about the new audit framework are made.

42. Local government is in the process of implementing International Financial Reporting Standards (IFRS), which should help to bring local government accounting more in line with financial reporting in other sectors. However, there is further opportunity brought about by the proposal to abolish the Commission for DCLG to review the overall accounting and reporting framework within local government and simplify it. In particular, it could take the opportunity to review the complex capital accounting regime and various trading accounts that exist within the framework which are unique to local government within the UK. Such accounting does not exist within other sectors.

43. If local government accounting were brought more into line with central government accounting and indeed more in line with a set of company financial statements it would help to bring about consistency in financial reporting, not just within local government but also with other sectors. It would no doubt help the consolidation process that will be required for the Whole of Government Accounts reporting initiative. Reducing reporting complexities in the sector could also help increase the audit market participation as less specialisation would be required.

44. In our view, there should first be a duty upon audited bodies themselves to report on their own arrangements on the services they provide. One way of achieving this would be through the publication of an annual report. Auditors could then provide an opinion on whether the information contained within the annual report was consistent with the financial statements. This would be in line with auditors responsibilities for Companies Act audits. We acknowledge that this may not be well received by the sector and would require some changes within local government accounting and reporting frameworks. Other sectors, including central government, the corporate and banking sectors and companies already publish annual reports, therefore this would bring local government into line with other sectors. This would also meet and be consistent with a wider government policy on transparency and accountability and could indeed result in a reduction in audit costs if auditors are only reporting on management’s assertions.
45. Currently having audit committees within an authority’s structure is voluntary rather than mandatory. This is inconsistent with other sectors. Having an audit committee with independently appointed members is, in our view, key to the success of the government’s intention of independent appointment of auditors. The audit committee, with its independent membership, could provide some protection to the audit firm from the threat of termination of contract by management.

46. Local authorities currently receive more than £46 billion worth of grants and funding from government departments. The Commission currently makes arrangements for the certification of the claims and returns that local authorities are required to submit to government departments to indicate that the monies that they have received have been spent in accordance with the terms and conditions of the grant schemes. Under the current arrangements, the appointed auditor provides the assurance on these claims and returns to government departments based on certification instructions (which are agreed in advance with government departments by the Commission). Each separate assurance report on each grant claim that an auditor provides at each local authority is subject to separate fees.

47. Under a new framework, government departments would need to play more of a role in engaging with the auditor and the grant recipient. This, in practice, may be more difficult, because of the number of grants and number of bodies that receive such funding. However, there are already similar arrangements in place when funds are allocated to private sector organisations. ICAEW has a framework document (published in March 2010) which outlines the key issues in this area. This could, in our view, be easily transferred to grants received by public sector organisations. However, it would mean that grant-paying bodies would need to review their own arrangements, take on more responsibility for identifying their requirements and be prepared to have discussions with auditors (or the auditors’ accountancy bodies) to ensure that there is no expectations gap.

Audit of small bodies

48. The audit requirements for smaller bodies (such as parish councils) are currently the same as for larger bodies. Although, for a number of years, the Commission has operated a ‘light touch’ audit for smaller bodies with the smallest bodies not paying any fees for their annual audit.

49. We note the government’s intention to consider how it treats parish and town councils and other bodies and to ensure that a more proportionate approach is adopted, similar to that which applies to small companies and charities.

50. We are in favour of a more proportionate approach being considered and adopted and our suggestion would be for government to set a turnover threshold for a full audit similar to that of small companies (currently £6.5 million). We are also in favour of an approach similar to that adopted by the Charity Commission ie the independent examination of bodies at the lower end of the scale.

51. We are, however, not in favour of a regime whereby each small body will be required to appoint its own auditor. The smaller parish councils do not necessarily have the skills or expertise to appoint their own auditor and it would not be appropriate to place this additional burden on them, which would inevitably be at a cost.

52. For the smaller end of the scale, our view is that the precepting authority (to whom the parish is accountable) should take the responsibility for carrying out some checks of how the precept is spent. The precepting authority could use its own internal auditors or perhaps even its external auditors for this purpose (recognising that they were would be cost involved in using its external auditors).

A W

January

Written evidence submitted by the Financial Reporting Council

1. INTRODUCTION AND MAIN POINTS

1.1 The Financial Reporting Council (FRC) welcomes the opportunity to give evidence to the Select Committee’s inquiry into The Audit and Inspection of Local Authorities.

1.2 The FRC is the United Kingdom’s independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC and its operating bodies have a number of responsibilities in relation to Companies Act audit, including policy, standards, monitoring and investigations. These functions are carried out with the primary goal of improving audit quality.

1.3 The FRC currently has no statutory powers in relation to the audit of local authorities and other public bodies. However, our Audit Inspection Unit (AIU) has been contracted to inspect certain of their audits. Additionally, both the Audit Commission and the National Audit Office observe the Auditing and Ethical Standards established by the FRC’s Auditing Practices Board.
1.4 Since the announcement of the Government’s intention to abolish the Audit Commission, we have met the Department for Communities and Local Government (DCLG) to give our views on the shape of future regulation of public sector audit and the implications of the abolition of the Audit Commission for the corporate audit market.

1.5 In order for taxpayers and electors to have confidence in the audit of local authorities it is vital for an effective regulatory system to be in place.

1.6 There are differences between private and public sector audit. However both depend on independence, objectivity and transparency if they are to be effective and hold the confidence of the investor or citizen. We believe therefore that regulation of the audit of public sector bodies should mirror as far as reasonably possible arrangements for private sector audit. We propose that the primary responsibility should rest with one or more of the professional accountancy bodies. The FRC should provide oversight of that body’s work and would also have direct responsibility for the monitoring and investigation of the audits of major public interest entities.

1.7 We also believe that the abolition of the Audit Commission should be used as a catalyst to provide greater competition in the audit market. We understand that the Commission’s in-house audit practice is the fifth largest in the UK. Although this work is not in the corporate sector, if the work and resources were to be secured by a non Big Four firm it would enhance their scale and strength and so reinforce their ability to compete in the audit market more generally. Conversely, if the work goes to one or more of the Big Four, the reverse will be true.

2. REGULATING THE AUDIT OF LOCAL AUTHORITIES AND OTHER PUBLIC BODIES

2.1 As noted above, primary responsibility for most aspects of the regulation of Companies Act audits rests with the professional accountancy bodies. The work of the bodies includes:

— Licensing and registration of audit firms and individuals permitted to sign audit reports;
— Education and training, including monitoring the continuing professional development of members;
— Monitoring the audit quality of engagements and firms which do not fall within the scope of the Audit Inspection Unit (see below); and
— Complaints-handling and disciplinary investigations which are not considered major public interest matters.

2.2 The FRC, through its operating bodies including the Professional Oversight Board, provides independent oversight of the regulation of Companies Act audits and general accountancy services by the professional accountancy bodies. The former is on a statutory basis; the latter is by agreement with the professional accountancy bodies.

2.3 The abolition of the Audit Commission means that, for the first time, local authorities will take responsibility for the appointment of auditors. It is important that confidence in the auditor appointment process is maintained. To assist with this we support the creation of independent audit committees. These audit committees would assess the quality of the external audit and make recommendations to the local authority on the appointment, re-appointment and removal of auditors.

2.4 A recent FRC paper suggests ways in which private sector audit committees could make a greater effort to engage with investors about the audit process. Similarly, local authority audit committees should be responsible for the provision of information to electors on the appointment and reappointment process. There may also be circumstances where the audit committee would meet with individual electors or associations of electors to hear representations regarding the auditors or the audit process.

2.5 We set out our thinking on the possible future regulation of local authority audits in greater detail in Appendix A.

3. COMPETITION ISSUES

3.1 The market for the audits of the UK’s largest companies is highly concentrated. The “Big Four” audit 99% of the FTSE 100 and 95% of the FTSE 250.

3.2 There are various reasons for this concentration, which has built up over many years. Some of the most important include:

— The desire for the largest and most complex global companies to use an audit firm with a strong international network.
— Difficulty for new or growing audit firms to raise sufficient capital to expand into the market for the largest companies.

55 There are six Recognised Qualifying Bodies in the UK and five Recognised Supervisory Bodies. The former are entitled to offer the audit qualification and the latter supervise auditors and audit firms.
56 “Effective Company Stewardship”, FRC, 2011
57 The “Big Four” audit firms are Deloitte, Ernst Young, KPMG and PricewaterhouseCoopers.
— The ability for audit firms to achieve sufficient scale to absorb the cost of investment in new or emerging markets.
— The increased size and complexity of companies being audited.
— Regulatory decisions permitting the Coopers & Lybrand Price Waterhouse merger.
— The collapse of Arthur Andersen.\(^{58}\)
— Market perception or the “IBM factor”;\(^{59}\) there is evidence that listed companies are often reluctant to choose a non-Big Four auditor for real or perceived reputational reasons. On occasion this perception we are told is backed up by contractual obligations, for example clauses in loan covenants which specify that the company may only engage certain auditors.

3.3 Negative features of the current audit market include:
— The potential for moral hazard if the largest firms become “too big to fail” and judge that governments and regulators will be reluctant to take enforcement action against them if that action had the potential to result in the firm leaving the market. At the FRC we would not moderate our actions to protect a firm from failure but it is of concern that some believe such a risk exists.
— Lack of choice for large companies, particularly those in certain industries (such as banking and insurance) where only two or three firms are judged to have the appropriate expertise to act as auditor. If the company uses another large firm for other services, such as corporate finance, it may find itself without an effective choice of auditor in the short term due to independence restrictions.
— Lack of innovation in audit, with all large firms offering a virtually identical product\(^{60}\). Regulatory restrictions on the scope of audit, independence rules and the format of the audit report offer only a partial explanation for this lack of innovation.

3.4 Our most immediate concern is that in this highly concentrated market for audit services the failure of one of the Big Four would have serious consequences for companies and investors. Such a failure may be unrelated to audit; all of the large firms operate other lines of business, some of which, such as corporate finance, are inherently risky and could have significant adverse impact on their reputation with clients and prospective clients. In addition, as the large firms are all members of international networks, the event would not necessarily have to take place in the UK. Whatever the nature and cause of the event, the subsequent collapse of public confidence in the stricken firm could quickly result in an exodus of clients and senior personnel, effectively destroying the business.

3.5 A large firm leaving the market risks creating severe disruption to capital markets in the UK and globally. Many clients of the collapsed firm would be unable to obtain an alternative auditor in the short-term and so would find themselves unable to meet corporate reporting deadlines. Investors could also lose confidence in the financial statements of the firm’s audit clients. In the longer term, the difficulties around lack of choice and independence conflicts identified above would be exacerbated. Additionally, if the event were audit-related, the remaining firms may become reluctant to audit companies in high risk industries and may even begin to withdraw from certain sectors of the market. At a minimum, a market with three or fewer large firms is likely to require a significantly more intrusive regulatory environment and therefore cost.

3.6 Concentration in the audit market therefore poses a systemic risk to the UK economy. The FRC has been concerned about this for some time and in 2006 commissioned (jointly with the DTI) a study\(^{61}\) by consultants Oxera on the UK audit market. Following the publication of the Oxera study, the FRC consulted on a discussion paper seeking stakeholder views on mitigating risks arising from market concentration. Respondents to the discussion paper had a clear preference for market-based solutions to these risks and to assist in the identification of such solutions the FRC created the Market Participants’ Group (MPG) which issued 15 recommendations\(^{62}\) aimed at reducing risk and increasing choice in the audit market.

3.7 The FRC has been monitoring the implementation of these recommendations and published the most recent Progress Report in June 2010. The majority of the recommendations have been implemented but to date this market-based approach has had minimal impact on market concentration, and in our view there is now a need to consider a different approach.

3.8 Against this background, the abolition of the Audit Commission therefore represents a rare chance to speed up the growth of a fifth player.

3.9 The Audit Commission, if kept together as a business, whether employee-owned or under entirely new ownership, would we understand be the fifth largest audit firm in the UK. This entity would not initially be in a position to carry out Companies Act audits in its own right, as the majority of its staff do not have an

\(^{58}\) Andersen’s global network collapsed shortly after the US firm was indicted on a charge relating to its role in the Enron failure. The US firm was subsequently convicted of the charge but this conviction was overturned by the Supreme Court. This came too late to save the firm

\(^{59}\) “No one gets fired for buying IBM”

\(^{60}\) The only recent example we have seen of innovation in the audit product is the “extended audit” service offered to some large companies such as Rentokil plc.

\(^{61}\) “Competition choice in the UK audit market”, Oxera, 2006

\(^{62}\) “Choice in the UK audit market: final report of the Market Participants’ Group”, FRC, 2007
appropriate qualification and or relevant experience. However, if the Audit Commission was to form an alliance with an existing mid-tier audit firm it would in time be able to expand into this market.

3.10 To ensure that the new entity has an appropriate platform for success, we would suggest you consider the need for transitional arrangements, such as ring-fencing current Audit Commission engagements for a period of years.

4. **Conclusion**

4.1 We believe that the regulatory model for the regulation of Companies Act audits provides a suitable template for the future regulation of the audits of local authorities and other local public bodies.

4.2 The abolition of the Audit Commission should be used as a catalyst for increasing choice in the audit market.

4.3 The FRC stands ready to work with the Committee and DCLG staff to identify and implement practical and workable policies that will sustain and enhance the quality of local authority and public sector audits.

*anuary*
### KEY REGULATORY ACTIVITIES

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<th>Activity</th>
<th>Description</th>
<th>Responsible bodies to mirror that of Companies Act Audits</th>
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| Scope of work and standard setting | The population of entities requiring audit will need to be agreed. As part of this we would encourage the setting an audit threshold, similar to the approach in the Companies Act, which would grant the smallest bodies, such as parish councils, an audit exemption. Public confidence in these small entities could be maintained by other means, such as publication of accounts and lists of income and expenditure. The standards under which these audits will be performed will need to be established. This will include auditing, accounting and ethical standards. Currently the audits of public sector bodies are carried out under the Audit Commission’s Code of Practice as set out in the Audit Commission Act 1998. The Code of Practice includes a requirement for auditors to comply with the auditing and ethical standards and guidance issued by the FRC’s Auditing Practices Board (APB). Currently, the Audit Commission decides who should be appointed to audit a local authority or other public body and may decide that it should carry out the work or that one of the five firms currently on the panel should be appointed. Given the abolition of the Audit Commission this will clearly need to change. Consideration should be given to:  
  - The process for appointment and removal of auditors  
  - Whether decisions made by the management of a local authority or other body will require ratification by a wider group of stakeholders  
  - The period of the appointment | Determining the population should be a matter for statute, as is the case with Companies Act Audits. Accounting, auditing and ethical standards are set by the FRC’s operating bodies. The Code of Practice will need to be amended and updated by another body, most likely the National Audit Office. We support the creation of independent audit committees to assess the quality of the external audit and make recommendations to the local authority on the appointment, re-appointment and removal of auditors. |
| Licensing and registration        | Individuals and firms who are entitled to carry out the audits of public bodies will need to be licensed. Consideration should be given to the:  
  - Qualifications and experience that an individual will be required to obtain prior to being permitted to lead an audit engagement and or sign an audit report  
  - Conditions firms will need to meet in order to obtain a licence to conduct public sector audits. A register of these individuals and firms should be set up and made accessible to the public, probably via a website as is the case for the statutory audit register | Licensing and registration activities should rest in the first instance with one of the existing accountancy professional bodies overseen by the FRC POB. The FRC has asked government to consider requiring auditors of listed companies to obtain an additional licence to operate and has suggested it might be best placed to run this process. If this is instituted, a similar approach should be introduced for the auditors of the largest local authorities. |
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<th>Activity</th>
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<td>Monitoring</td>
<td>A monitoring process will need to be put in place. This should cover: A system should be introduced to enable clients and members of the public to raise concerns about the conduct of an individual auditor or firm. A disciplinary mechanism is also needed to address instances where the conduct or competence of an individual or firm falls significantly below what is expected. In serious cases, it may be necessary to withdraw or suspend an individual or firm’s licence to audit public bodies. Examples of misconduct or incompetence may come to light through monitoring activities or through complaints from clients or others.</td>
<td>Reviews of smaller audits could be carried out by the monitoring units of the existing professional accountancy bodies overseen by the FRC POB. Major Public Interest audits could be monitored directly by the Audit Inspection Unit (AIU). The majority of complaints and disciplinary cases should be handled by one or more of the existing accountancy professional bodies overseen by the FRC POB. Serious public interest matters could be referred to the FRC’s Accountancy and Actuarial Discipline Board (AADB)</td>
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Written evidence submitted by the Department for Communities and Local Government

1. Summary and Introduction

— The Audit Commission was set up in 1983 to audit local authorities, to improve the quality of local audit and to promote and develop value for money studies. This role expanded over time to include audit of other organisations, such as local health bodies, and an increasing amount of inspection activity across the local government sector. In particular, from 2002 (2003 for district councils), the Commission was responsible for the system of Comprehensive Performance Assessment, which itself was replaced from April 2009 by the Comprehensive Area Assessment regime.

— Following its establishment, the Audit Commission increased the professionalism and quality of local government audit, and its in-house audit practice continues to be well-respected. However, the Commission also became overly focused on reporting to central government and supporting Whitehall oversight of local bodies.

— The Government is clear that such centralised inspection and supervision is both an unnecessary burden on frontline services and is detrimental to the genuine local accountability that is essential if local services are to be efficient and meet the needs and aspirations of local communities.

— Accordingly, on 25 June 2010, the Government instructed the Audit Commission and five other inspectorates to stop Comprehensive Area Assessments. On 13 August 2010, the Government announced plans to disband the Audit Commission. These decisions are part of a fundamental shift in power away from central government to councils and communities, overturning decades of increasing central government control.

— This memorandum outlines how the Government is taking forward the establishment of a new, more localist, audit regime. The underlying principles on which the Government believes any such regime should be based. Given the terms of reference for this inquiry, the memorandum largely addresses these issues from a local government perspective.

— As Ministers have made clear to Parliament, the Government is developing proposals for a new local audit regime with the Audit Commission, the National Audit Office, the Financial Reporting Council, local government, audit firms and other interested parties. Close involvement of the Audit Commission in this work is essential to secure an effective transition, and the Department is grateful for the Commission’s constructive participation.

— The Government will be seeking views widely on the proposals, and will want to have careful regard to the Select Committee’s report. A first consultation on the details of a new audit framework is planned for early in 2011, and the Government envisages that it may subsequently publish a draft Bill for pre-legislative scrutiny, ahead of the final introduction of legislation to Parliament. Following such consultation and scrutiny it is the Government’s intention to introduce the necessary legislation at the earliest opportunity.

— As to the underlying principles, local bodies—councils and local health bodies—will continue to be subject to robust and efficient auditing that follows the established principles of public audit. Any new local audit regime will provide full and appropriate accountability, ensuring that local authorities are effectively accountable to local communities for their spending decisions. Local audits would thus continue to have the wide scope of public audit, covering the audit of financial statements, regularity, propriety, and value for money.

— The Government considers that the current arrangements for local audit, whereby a single organisation—the Audit Commission—is the regulator, commissioner and provider of local audit services are inefficient and unnecessarily centralised. Accordingly, the Government intends to move the work of the Audit Commission’s in-house practice into the private sector. It will put in place new arrangements, with stringent safeguards to ensure independence, for councils to appoint their auditors, and for the appointment of auditors to local health bodies.

— For the future, the Government envisages that the National Audit Office, given its role in providing Parliament with assurance on public spending, would have oversight of auditing standards; the professional accountancy bodies, as supervisory bodies under the oversight of the Financial Reporting Council, would maintain a register of firms and auditors that are eligible to undertake local public audit engagements; and quality assurance and monitoring of audits, under the Financial Reporting Council’s oversight, would be undertaken by the supervisory bodies and the Council’s Audit Inspection Unit (in the case of larger local bodies).

— The Audit Commission’s inspection activities will stop. In future, any central inspection will be focused on the most vulnerable, for example to help maintain high standards in children’s services and adult social care. Intervention will focus on cases of serious risk or failure. The Commission’s National Fraud Initiative should continue, and this Department is in discussions with a number of bodies that have expressed an interest in taking on the Initiative. The Audit Commission’s research activities, including its value for money studies, will cease. The National Audit Office’s value for money studies will be able, as they can currently, to cover activities of local bodies.
2. THE WORK OF THE AUDIT COMMISSION

1. The Audit Commission was set up in 1983 as a self-funding, independent body to secure the audit of local authorities, promote and undertake value for money studies and to increase both the expertise of government auditors and the impact of external audit.

2. The Audit Commission’s role developed under successive governments until, at the time of the last General Election, it encompassed:

   (A) Audit of local authorities, NHS Trusts and other local bodies in England. A full list of bodies audited by the Commission is at Annex A.
   (B) Assessment and inspection of the performance of councils, fire and rescue services and housing association.
   (C) Research (including value for money studies), on a wide range of social and financial issues.
   (D) Assurance functions, including data-matching through the National Fraud Initiative and grant certification on behalf of Government Departments.

3. AUDIT OF EXPENDITURE BY LOCAL PUBLIC BODIES

3. The Audit Commission currently combines within one body the regulation and commissioning of public audit, as well as providing auditors for 70% of local bodies. The Government is committed to strengthening democratic accountability and decentralisation of decision making. As part of that, it is committed to developing a decentralised approach to the external audit of public bodies.

4. As regulator of the current local audit regime, the Commission sits alongside and partially overlaps the more extensive audit regulatory regime of the Companies Act audit sector. The Government considers that having a specific regulator for the local government sector and the local health sector is inefficient and risks duplication.

5. The Government therefore believes there should be a single regulatory regime for audit, covering the private sector and the local government and local health sectors. This single regime can be more readily tailored to local accountability—in the way that the commercial sector is tailored to shareholders—rather than accountability to central government, as is the case with the Commission.

6. However, the local audit regime cannot entirely replicate the private sector regime because of the need for accountability to Parliament and Government and the nature of the activities required to provide those assurances. It is also necessary for the audit of public bodies to follow the principles of public audit.

7. The Audit Commission currently appoints all auditors of the local bodies listed in Schedule 2 of the Audit Commission Act 1998 (as amended). However, the Government believes that, in the case of elected local bodies, centralised commissioning of audit services is fundamentally inconsistent with the concept of accountability to the electorate. Under the Government’s proposals, authorities would appoint their own auditors. However, the principle of auditor independence will be retained as a cornerstone of the new regime. In this respect, independence encompasses the methods of appointment of auditors, the financial relationship between auditors and audited body, discretion in the amount of work necessary, the ability to follow up recommendations, and free access to information.

8. The Audit Commission’s in-house audit practice provides auditors to 70% of local public bodies, with the remaining 30% of auditors employed by accountancy firms under contract to the Commission. The Commission sets fees for auditing work on a “post office pricing” basis, whereby all principal authorities pay the same rates, which include a surcharge of around 20% to cover the costs of the Commission’s work. The direct commissioning of audit services by the local bodies should therefore reduce fees by removing the Commission’s overheads.

9. The in-house audit practice is well respected and has consistently done a good job. However, the Government does not believe that there is a rationale for the audit practice—the fifth largest provider of audit services in the UK—remaining in the public sector. The Government expects that the commissioning of audit services directly, and through a genuinely competitive process will be more efficient, effective and locally accountable than the current arrangements.
The proposed new audit regime

10. Subject to consultation and Parliamentary approval, the new regime will consist of:
   - Regulation—The Government expects regulation, monitoring and quality control to be undertaken by one or more of the accountancy professional bodies, with independent oversight provided by the Financial Reporting Council and its operating bodies. The Financial Reporting Council would have direct responsibility for certain matters: for example its Audit Inspection Unit would carry out the monitoring of the largest public interest audits. The National Audit Office would provide the necessary oversight of auditing standards, including responsibility for developing and maintaining the audit codes and supporting guidance.
   - Commissioning—auditors would be appointed by local bodies with appropriate stringent safeguards built into the audit framework to ensure audit independence is maintained. Competitive appointment will be from those licensed in accordance with the regulatory regime, bringing an end to centralised commissioning.
   - Provision—audit would be undertaken by private sector commercial firms, licensed by the regulator and appointed through a competitive process, charging commercial market rates.

11. The design principles underpinning the new local audit regime include maintaining audit standards and ensuring independence, competence and quality.

12. The Government expects that the scope of audit will cover:
   - regularity and propriety—the auditor would need to be satisfied regarding compliance with legal requirements and control mechanisms.
   - financial statements—the auditor would give an opinion as to the whether accounting statements give a true and fair view of the financial position and of income and expenditure.
   - value for money—the auditor would need to be satisfied as to whether there have been effective arrangements to secure economy, efficiency and effectiveness.
   - financial resilience—the auditor would need to be satisfied as to whether there are any risks to the future financial sustainability and whether mitigation action taken.

The scope of audit would be set out in the audit codes and supporting guidance that would be developed and maintained by the National Audit Office.

13. Auditors would still consider matters in the public interest through public interest reports. They would be able to undertake, possibly as part of a wider team, further inspections, such as corporate governance inspections, where they considered this necessary to meet their public interest responsibilities. They could also carry out such inspections if requested to do so by the audited body, one of the continuing inspectorates or the Secretary of State. More generally, auditors would be able to undertake audit-related value for money investigations, with the agreement of the body.

14. To help ensure independence, the Government envisages that councils would be able to appoint the same audit firm for a fixed number of years, but they would not be able to reappoint the same responsible individual for successive periods. The new regime would ensure that members of public could still make representations to auditors.

15. The Government is considering very carefully how to treat parish and town councils and other small bodies under the new framework, to ensure that a proportionate approach is adopted, perhaps similar to that which applies to small companies and charities.

consultation

16. The Government intends to consult on the detail of the new local audit framework early in 2011. It also envisages that it may publish a draft bill to allow full scrutiny of the proposed legislative framework, ahead of final introduction of legislation in Parliament.

Transferring in house audit work to the private sector

17. The Government is working with the Commission and other partners to develop and assess a range of options for the transfer the work of the Commission’s in-house audit practice to the private sector. In assessing options, it will seek to secure strong value for money for taxpayers, including local taxpayers. The Government would be happy to see a mutual set up by existing Audit Commission staff, if this proves to be appropriate and practical.

Timetable

18. The Government has stated that reforms to the local audit regime are likely to take effect from 2012/13. However, it will take account of the views expressed by the Select Committee and responses to the planned consultation on the new local audit framework and will review the implementation timetable in the light of these views.
4. OVERSIGHT AND INSPECTION OF LOCAL AUTHORITY PERFORMANCE

4.1. Background

19. Inspection and assessment have played an increasing role in the governance of public bodies, including local authorities. From April 2009, the main programme of inspection and assessment for local authorities was the Comprehensive Area Assessment, which attempted to provide an overall picture of how councils and their partners were delivering services and outcomes for local people.

20. However, inspection and assessment placed costly burdens on local service providers and made them focus on reporting to central government rather than delivering the services their citizens wanted. For this reason, the Comprehensive Area Assessment was abolished in June 2010.

21. The Government is decentralising power in many areas of local authorities’ work, including education, health, and housing. In November 2010, this Department announced the end to the strategic housing inspections previously carried out by the Audit Commission. The Department of Health also announced the ending of annual performance assessments of councils under the Care Quality Commission’s current framework, while Ofsted announced, in December 2010, the phasing out of the annual children’s services assessment.

4.2. Increasing local accountability

22. Local government performance has improved over a number of years, and local authorities are well placed to deliver services that local people want, independent of central control. The Government wants to free up local authorities to enable them to be innovative in the delivery of services, rather than merely seeking to raise performance against centrally established criteria to achieve good inspection results. Local authorities will have the freedom to deliver services in ways that meet local needs, and will be accountable for those services to their electorates. These principles are key elements of localism.

23. The Government is committed to increasing transparency across Whitehall and local authorities and will make data more readily available to the citizen to allow them to hold politicians and public bodies to account. The Secretary of State has called upon councils to increase transparency and openness by publishing information on senior salaries, councillor allowances and all spending over £500. These are first steps, but the Government is considering other types of data that should be more accessible, such as council minutes and papers, performance data, food hygiene reports and licensing applications. Greater transparency will help root out overspending and waste in local government.

24. A key part of the change will be putting information into the public domain in an accessible and readily comparable format so people have access to the information they need to judge the performance of their local service providers, and hold them to account. National government will still have a role to play in aggregating data of national importance, or to allow accountability to Parliament, but it is for local authorities to provide local residents with the data they need.

25. This Department is putting together the single data list of all the data that central government requires from local government. The principal aim is to reduce the burden of data collection on local government, but all of the data is being assessed to ensure that it needs to be aggregated at the national level. The exercise will provide a transparent catalogue of all data that central government collects from local government.

26. The Government is also committed to creating a new “right to data” to empower citizens to request access to government-held datasets if they feel they need more information. The Government fully supports the work being done by local government as part of the Place Based Productivity Programme to develop effective benchmarking tools to allow citizens to compare their local council’s performance against others.

4.3. Future of inspection and the role of inspectorates

27. Approaches to inspection and assessment of local authorities are being developed across Government in the light of the decentralisation and localism agenda. Key principles include independence from the service providers and accountability for the most vulnerable. The benefits of inspection must outweigh the costs, including those of the inspected body. Those local service inspectorates that remain must provide credible judgements for the public and have a clearly defined purpose which focuses on public protection. The sharing of information by inspectorates can help identify where service failures in one part of an authority are linked to broader questions about the authority’s capacity to manage its overall corporate responsibilities effectively.

28. The Department for Education is working with Ofsted, which is making changes to its inspection arrangements to reduce costs and burdens, re-focus on key priorities and ensure they are proportionate. The statutory duty on Ofsted to publish an annual rating for children’s services will be repealed as soon as a suitable legislative slot is identified. Details of future changes to safeguarding and children’s social care inspection, and early years and childcare inspection reforms will be informed by the results of the reviews carried out by Professor Eileen Munro and Dame Clare Tickell. Extensive reforms to schools inspection are already underway.

29. The Department of Health has agreed a new approach to the assessment and inspection of councils. The annual assessment of councils as commissioners of adult social care has been discontinued, and the Care Quality Commission will no longer publish information about council performance. This new approach will
see a shift towards more sector-led assessment, with councils taking greater responsibility for driving improvement. The Care Quality Commission will retain the ability to respond to concerns about council services by carrying out inspections. The Department of Health will continue to work with the Care Quality Commission and local government organisations to develop the detail of the new approach.

5. Research

30. The Audit Commission has undertaken research (including value for money studies) and produced national reports on a range of issues of interest to its customers. In 2008–09 it produced twenty three national reports including “Tougher at the Top”, about the role of local authority Chief Executives, “Well Disposed”, about how councils are responding to the challenge of reducing the amount of waste sent to landfill and “Risk and Return”, about how the collapse of banks in Iceland affected English local authorities.

31. However, local government and others outside of central Government are well-placed to decide when and where research should be undertaken. The Government expects that value for money will remain an important component of local audit. The National Audit Office, using its existing powers, will be able, when reporting to Parliament on the activities of central government departments, to directly examine the impact of policies administered by local bodies. This will contribute to parliamentary accountability, as well as providing useful insights for local communities.

32. It will also be possible for an auditor to undertake value for money studies connected to audit work, with the agreement of the audited body. In addition, the National Audit Office would be able to identify wider issues of concern about local bodies’ use of resources in general, should such issues be identified by the audit process.

6. Assurance Functions

33. The National Fraud Initiative (NFI) is a data matching exercise, which is run under the Audit Commission’s statutory data matching powers. The NFI works within a strong legal framework, including the Data Protection Act 1998, which is designed to protect individuals’ personal data.

34. The NFI plays an important role in protecting the public purse against fraud. For example, fraudsters often target different organisations at the same time, using the same fraudulent identities. The NFI combats this threat by comparing or “matching” information held by different organisations and within organisations to identify anomalies that indicate potentially fraudulent claims and overpayments.

35. A key strength of the NFI is that it brings together a wide range of bodies in tackling fraud. It helps individual organisations go beyond what they could do acting alone. The last NFI exercise in 2008–09 processed some 8,000 datasets from 1,300 organisations, including 100 from the private sector; It helped trace £215 million in fraud, error and overpayments bringing the total detected since it started in 1996 to £664 million.

36. The Government is currently considering how the function might be delivered in the new audit environment and is discussing this with other bodies that have an interest in ensuring its future. In the meantime the 2010–11 exercise is continuing as normal.

37. Under section 28 of the Audit Commission Act 1998, the Audit Commission makes arrangements for certifying claims and returns in respect of grants or subsidies from Government Departments. Auditors also certify other financial returns such contributions payable to the national non domestic rating pool, and the Commission provides significant technical guidance, advice, tools and system support for auditors.

38. Certification work is separate from audit and is a form of assurance engagement designed to provide assurance for the accounting officers of the grant paying bodies and contribute to the assurance sought by the National Audit Office when auditing grant-paying bodies.

39. It is the Commission, rather than its appointed auditors, that has the responsibility for making certification arrangements. In discharging this function the Commission works with each of the grant paying bodies to develop certification instructions specific to each grant scheme, and which must be followed by auditors appointed by the Commission. It also provides technical guidance, advice and tools to auditors and the grant paying bodies to ensure a consistent approach.

40. In future, the Government envisages that grant certification will be undertaken by the external auditor. The certification arrangements will continue to be proportionate to the amount of the claim and the auditors’ assessment of the control environment involved.
7. CONCLUSION

41. In conclusion, the Government has already removed burdens on local authorities and is committed to reducing further central Government control and monitoring. It is disbanding the Audit Commission and refocusing audit on helping local people to hold councils and local public bodies to account for local spending decisions.

42. The Government is working with a wide range of partners to design a new local audit regime, and prepare the in-house practice for transfer to the private sector, wind down the Commission and transfer any residual functions that are to be retained. The primary legislation necessary to make these changes will be introduced at the earliest opportunity. In the meantime, the Government will consult on its proposals for a new audit regime and will consider whether a draft bill would be helpful as a means of achieving early scrutiny of legislation.

Annex A

LIST OF BODIES TO WHICH THE AUDIT COMMISSION APPOINTS AUDITORS

A local authority.
A joint authority.
The Greater London Authority.
A functional body.
The London Pensions Fund Authority.
A parish meeting of a parish not having a separate parish council.
A committee of a local authority, including a joint committee of two or more such authorities.
The Council of the Isles of Scilly.
A body specified in section 98(1) of the National Health Service Act 1977 (as amended and consolidated).
A port health authority.
The Broads Authority.
A national park authority.
A conservation board established by order under section 86 of the Countryside and Rights of Way Act 2000.
A police authority established under section 3 of the Police Act 1996.
A fire authority constituted by a combination scheme.
A licensing planning committee.
An internal drainage board.
A local probation board established under section 4 of the Criminal Justice and Court Services Act.
The accounts of the collection fund of the Common Council and the accounts of the City fund.
The accounts relating to the superannuation fund maintained and administered by the Common Council under the Local Government Pension Scheme Regulations 1995.
Passenger Transport Executive.

Supplementary written evidence submitted by the Department for Communities and Local Government

ARRANGEMENTS FOR SMALLER BODIES

When I gave evidence to the Select Committee on 4 April I discussed the proposed arrangements for smaller bodies, those with income or expenditure not more than £6.5 million. David Heyes asked me to provide a breakdown of expenditure within the different levels for those bodies up to the proposed threshold, and I said that I would write back with the figures we have available.

We do not hold this information for those bodies up to £1 million as those figures are not routinely collected. However, the estimated Gross Revenue Expenditure for those bodies between £1 million to £6.5 million in 2010–11 is £165 million. I should clarify, though, that our proposals would not move any further public money outside of the requirement to have a full audit; smaller local public bodies are currently subject to limited
assurance, rather than full audit, and the threshold for this has recently been increased to £6.5 million, bringing a further 100 bodies within that regime. The independent examination we propose will, of course, provide assurance that the accounts of the bodies involved continue to be reviewed by an independent person.

As you know, both the companies and charities sectors have arrangements in place to ensure a more proportionate level of audit for smaller bodies. We remain keen to ensure that smaller local public bodies will not be disproportionately affected by our proposals, which are discussed in our consultation document on the future of local audit. I look forward to considering the responses we receive.

rant  happs
Minister for Housing and Local Government