House of Commons
Draft Local Audit Bill ad hoc Committee

Draft Local Audit Bill: Pre–legislative Scrutiny

Report of Session 2012–13

Volume I

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

Additional written evidence is contained in Volume II, available on the Committee website at http://www.parliament.uk/business/committees/committees-a-z/commons-select/draft-local-audit-bill-ad-hoc-committee/publications/

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Draft Local Audit Bill Ad hoc Committee

The Draft Local Audit Bill ad hoc Committee is appointed by the House of Commons to examine the Draft Local Audit Bill.

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Mr Richard Bacon MP (Conservative, South Norfolk)
Mr Clive Betts MP (Labour, Sheffield South East)
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Ian Swales MP (Liberal Democrat, Redcar)
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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.

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Summary

Local audit plays a vital role in assuring both the electorate and Parliament that local bodies are practising sound financial management and spending taxpayers’ money effectively. The draft Local Audit Bill confirms the Government’s commitment to abolishing the Audit Commission and outlines a new local audit regime. The proposed audit arrangements are shaped by four design principles: localism and decentralisation; transparency; achieving lower audit fees and; securing high standards of auditing.¹

This ad hoc Committee was established on 17 September 2012. The House asked us to consider the draft Bill which we interpreted to mean to consider whether the draft Bill would meet the Government’s objective of creating a more efficient and transparent local audit system with appropriate safeguards for protecting the integrity of the audit system, and ensuring accountability to local people.

The Government argued that the proposed audit regime would result in substantial long-term savings to the taxpayer. The impact assessment, published alongside the draft Bill, estimated that, on average, £137 million a year would be saved as a result of the proposed new regime. However, we heard conflicting evidence about the actual savings that would be realised. Given uncertainties about the figures in the impact assessment and the cost of local body compliance, we recommend that a new financial impact assessment is published alongside the Bill.

The draft Bill would provide a more complex and fragmented audit regime than exists currently, representing an awkward compromise between independent audit, a principle which has guided public sector audit for the last 150 years, and localism. We have a number of serious concerns regarding the practicability, workability and completeness of the proposals outlined in the draft Bill.

The draft Bill fails to provide adequate safeguards to guarantee the independence of audit, it falls short in addressing many of the technical aspects of audit and is silent on how high quality statutory local audit will be obtained and reviewed in the new regime.

The vast majority of our witnesses expressed strong support for the retention of a procurement capacity and we recommend that should be included in the Bill when it is presented to Parliament.

The draft Bill contains a number of risks and gaps which require urgent attention. It is clear that if the new regime is to be successful the Department for Communities and Local Government, along with other Departments, will have to be proactively engaged in its management. We are concerned that the draft Bill provides insufficient safeguards to whistleblowers that have drawn attention to serious governance failure. We strongly recommend that in addition to the appointed auditor, the Comptroller & Auditor General of the National Audit Office should also be named in the Bill as a prescribed person for

¹ Draft Local Audit Bill, Cm 8393, July 2012, p 2
whistleblowers to contact.

We welcome the Secretary of State’s stated openness to “reasonable” recommendations.\textsuperscript{2} The conclusions and recommendations contained within this Report would help ensure that the Bill better safeguards auditor independence and bridges the gaps within the proposed regime.

\textsuperscript{2} Qq 364-365
1 Introduction

Background

1. 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 after terminating the Comprehensive Area Assessment (CAA) on 28 May 2010.4

2. The Draft Local Audit Bill was published on 6 July 2012.5 The provisions contained in the draft Bill will have a profound impact on the arrangements for local audit in England. The Government invited Parliament to conduct pre-legislative scrutiny of the draft Bill in recognition that local audit is an essential tool for providing assurance to both the electorate and Parliament that local bodies are spending public money efficiently and effectively. Ensuring that these bodies are held properly to account for their spending of taxpayers' money in the new audit landscape is vital.

3. This ad hoc Committee was established on 17 September 2012. The House asked us to consider the draft Bill which we interpreted to mean to consider whether the draft Bill would meet the Government's objective of creating a more efficient and transparent local audit system with appropriate safeguards for protecting the integrity of the audit system, and ensuring accountability to local people. We comprise Members of four select Committees with a direct interest in the draft Bill's provisions. The Motion agreed by the House required us to report by 20 December 2012.6

The draft Bill

4. The draft Bill proposes a legal framework to replace the current regime which is managed by the Audit Commission. Since its abolition was announced, the Commission has completed a competitive procurement exercise where, for the first time, the entirety of the Commission’s in house audit practice was outsourced. The Government plans to introduce the new regulatory regime in 2015/16 and from 2017/18 local bodies would be able to appoint their own auditors by means of an Independent Auditor Panel. Those functions—previously carried out by the Commission which would be retained in the new regime—would be distributed among a number of organisations including the National Audit Office (NAO), Financial Reporting Council (FRC), Recognised Supervisory Bodies (RSBs) and sector based organisations like the Local Government Association (LGA).

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3 “Eric Pickles to disband the Audit Commission in new era of town hall transparency”, Department for Communities and Local Government press release, 13 August 2010
4 The Audit Commission worked with five independent inspectorates (Care Quality Commission, HMI Constabulary, HMI Prisons, HMI Probation and Ofsted) to introduce Comprehensive Area Assessment (CAA) in April 2009. CAA looked at how well public services like education, waste and recycling, health and social care, the police and the fire service were performing and how well they worked together to achieve better results for their communities
5 “Queen’s speech set out parliament plans for Local Audit overhaul”, Department for Communities and Local Government press release 9 May 2012
6 Committee of Public Accounts, Communities and Local Government Committee, Health Committee, and the Home Affairs Committee
5. On publication the draft Bill failed to address how its provisions would apply to Health bodies. It was not until 19 November 2012, at the end of our evidence gathering, that the Department of Health provided us with this detail. **The Department of Health failed to provide the Committee with appropriate and timely information in advance of our pre-legislative scrutiny of the draft Bill. It is very disappointing that the Department of Health acted in this way. As a result, we have been unable to consider this evidence properly and remain very concerned that proper scrutiny of the audit and accountability arrangements for Health trusts and commissioning groups should be carried out by Parliament. Nevertheless, we welcome the opportunity to look at the draft Bill in general.**

**Projected savings**

6. The Government has argued that the proposed audit regime would result in substantial long-term savings to the taxpayer. The impact assessment, published alongside the draft Bill, estimated that, on average, £137 million a year would be saved as a result of the proposed new regime. This equates to a net total saving of £1,151 million over ten years, with £650 million worth of savings recorded over the next five years.

7. However, other witnesses argued that the actual savings projected to be made from the implementation of the draft Bill were unclear. Some witnesses argued that the figures in the impact assessment were misleading. According to Marcine Waterman, Comptroller of Audit at the Audit Commission, “99% of the £650 million has been banked already”. She argued that abolishing the Audit Commission in its residual form would result in a saving of approximately £1.5 million a year from 2015/16. The impact assessment shows that the total annual cost of the audit regime in 2014/15, the final year of the Audit Commission, will be £85.1 million and the total annual cost of the new regime in 2018/19 is expected to be £82.73 million. This suggests that the draft Bill will achieve a modest annual saving of approximately £2.4 million a year. We heard evidence that these savings could be subsumed by regulatory and local body compliance costs associated with the new regime which the impact assessment estimates will be approximately £4 million and £4.43 million a year respectively. Furthermore, we heard concerns that some of the aspects of local body compliance, such as staff time, are difficult to quantify and may exceed the cost estimates made in the impact assessment.

8. We note that the Government’s use of 2009/10 as a baseline means that data for that year will include aspects of the Audit Commission’s work, including the Comprehensive Area Assessments and the Commission’s in house audit practice, which are either no longer being undertaken or are areas where savings have already been achieved. This area is complex. **The Government should include in the impact assessment an assessment of the savings made from abolishing the Audit Commission in its residual form. In order**

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7 Draft Local Audit Bill, Cm 8393, July 2012, p 17.
8 Total Net Present Value
9 Q 84
10 Written evidence from the Department of Communities and Local Government; also see Draft Local Audit Bill, Cm 8393, July 2012 p 18
11 Draft Local Audit Bill, Cm 8393, July 2012
to make accurate assessments of the total savings made by the draft Bill itself, the Government should use figures from 2011/12 as a baseline. Given uncertainties about the figures in the impact assessment and the cost of local body compliance, we recommend that a new financial impact assessment is published alongside the Bill.

Secondary legislation

9. Throughout the draft Bill there are instances where regulations are to be made through secondary legislation by negative rather than affirmative procedure. These include the development of different audit regimes for different bodies 12 and the power for the Secretary of State to make alterations to the operation of the Bill, and provisions made under it, in relation to authorities other than local authorities and the police. 13 We are not convinced that subjecting such regulations to negative procedure only is satisfactory; and neither has the Government provided any justification. In the interests of proper Parliamentary scrutiny, regulation should be subject to the affirmative procedure.

Our inquiry

10. On 20 September 2012 we issued a call for evidence to individuals and organisations with an interest in local audit and we are grateful to the organisations and individuals who provided evidence to our inquiry. 14 We were advised throughout by Gillian Fawcett, Head of Public Sector at the Association of Chartered Accountants and Tony Travers, Director of British Government, London School of Economics and Political Science. 15

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12 Clause 2(5)
13 Clause 10
14 A full list is provided on page 39
15 See formal minutes: http://www.parliament.uk/business/committees/committees-a-z/commons-select/draft-local-audit-bill-ad-hoc-committee/
2 The new audit regime

11. The draft Bill distributes the remaining functions of the Audit Commission amongst a myriad of other organisations and seeks to better align the procedures for public sector audit with the practices already in place for the private sector. Most witnesses agreed that the proposed new audit regime is more complex and fragmented than past arrangements where the Audit Commission effectively acted as regulator, commissioner and provider of audit. The new regime applies to a number of bodies (listed in Schedule 2 of the draft Bill) which are accountable to a range of Government departments other than the Department for Communities and Local Government. This means that there will be a significant challenge to ensure that the new audit regime will provide value-for-money and be co-ordinated effectively across departments.

12. In the proposed new audit regime, the Government intends that the National Audit Office (NAO) take on responsibility for the Code of Practice (the Code) and the Financial Reporting Council (FRC) will become the overall regulator and undertake a quality review of a sample of “major audits”. Professional accountancy bodies are identified as “recognised supervisory bodies” and will have authority to put in place rules and practices covering the eligibility of firms to be appointed as local public auditors and the qualifications, experience and other criteria that individuals must have before being permitted to carry out a local public audit.

13. Whilst larger bodies could readily absorb the changes, witnesses identified a series of risks and gaps within the proposed regulatory framework, in particular relating to the scope of audit; potential difficulties in coordinating the new audit regime across departments; accountability gaps at the department level; potential difficulties in maintaining audit quality and the ownership of the National Fraud Initiative (NFI).

Scope of audit

14. The Government’s intention to bring public sector audit in line with procedures for the private sector led a number of witnesses to express concern about whether the oversight arrangements in the draft Bill would adequately cater for the wider scope of public sector audit with respect to regularity, propriety, probity and value for money. Steve Freer, Chief Executive of CIPFA, asserted that:

One of the worrying features of the legislation is that the wider scope of public audit, which was certainly understood by the earlier Select Committee inquiry, is not strongly reflected in the legislation, or certainly does not seem to be reflected as strongly as it should be.
15. Steve Freer argued that although the FRC does have some experience in public sector audit, the roles ascribed to it under the draft Bill represent a significantly different line of work and would require the organisation to undergo a change in culture in order to properly reflect the specific needs of public sector audit. He further argued that public sector audit required additional specialism; in the currently regime this is provided by the Audit Commission.20

16. However, Paul George, Executive Director of FRC, argued that the FRC had made appropriate preparations in order to fulfil its new role. Mr George referred to the FRC’s existing work in the public sector audit; indicated that the FRC has been working closely with the Audit Commission; and drew attention to the experience of the FRC Chair, Sarah Hogg, who has significant experience of the health sector.21

17. Furthermore, in the proposed audit regime, the FRC becomes responsible for providing quality assurance on “major audits”. It is not clear how the Government defines “major audit” as the draft Bill merely puts in place a power for the Secretary of State to determine what it constitutes at a later date. Gillian Fawcett advised us that it is likely that the majority of local bodies will fall outside the definition of major audit and therefore will not be subject to quality assurance under the FRC. As a result, the pool of major audits will be so small that it is likely that they will be quality reviewed multiple times. We are not convinced that the Financial Reporting Council understands the wider scope of public sector audit. The Government should take appropriate steps to assure Parliament that the Financial Reporting Council, in taking on its new role, reflects the importance and character of public sector audit. The Bill, when presented to Parliament, should also define “major audit” and clarify how the quality of audit for bodies which fall outside this scope will be reviewed. We recommend that the performance of the new regulatory framework should be addressed directly in the Government’s post-implementation review.

The Code of Practice (The Code)

18. Amyas Morse, Comptroller and Auditor General (C&AG) of the National Audit Office (NAO) was confident that he will be in a strong position to take up responsibility for determining the Code of Practice and has made preparations to make this possible, including recruiting staff to the NAO who have experience of working for the Audit Commission.22 However, the C&AG told us that the Code would only provide high level information and would therefore be open to “too much flexibility and interpretation” as a result.23 We recommend that the draft Bill should be amended in order to provide the C&AG with a duty to publish detailed mandatory guidance to accompany the Code and that the C&AG should report annually to Parliament on the effectiveness of the Code.
Coordinating the new audit regime

19. Schedule 2 of the draft Bill lists the bodies which would be subject to the new audit regime. Many of these authorities are currently accountable to departments other than the Department for Communities and Local Government, for example Department of Health, Home Office, Department for Environment, Food and Rural Affairs and Department for Business, Innovation and Skills. Therefore some consideration will have to given as to how the new audit regime will be co-ordinated across departments.

20. The C&AG told us that the proposed regime could be made to work but that its success would largely be dependent on how the regime is implemented. He suggested that:

   It is not the only workable model, but it is a workable model. The proof of the pudding will largely be in the implementation and in how we work to improve that implementation over time.\(^{24}\)

21. The C&AG told us that effective integration by DCLG would be key to making the governance work, and suggested that “if it stands back, it will not work very well, and if it was actively and energetically involved, it can work well”.\(^{25}\) The C&AG further argued that:

   There are various issues where, if the Department is asking questions about how individual authorities are functioning, if it shows active interest in that, and if it sees published reports from auditors and picks them up and asks questions about them, that will make it efficient. If it is curious and constantly on the alert, that will send a message through the whole system.\(^{26}\)

The C&AG further argued that proactive engagement by the Department would be critical to the success of the new arrangements. Given this evidence, we were concerned to hear that the Secretary of State describe his Department’s role as “very much one of last resort”.\(^{27}\) We agree with the C&AG that the DCLG and other departments must engage fully in the new audit process if it is to be effective. In its response to this Report, the Department should set out what steps it will take to achieve this.

Accountability gaps

22. It is a fundamental responsibility of an Accounting Officer to manage and control resources used in a government department. In performing this duty an Accounting Officer is responsible for signing-off a key governance statement included in the department’s annual report. This statement is vital because it provides assurance to Parliament that resources are being used economically and effectively and that there are proper internal controls, including use of internal and external audit.

23. However, the draft Bill does not address how the Accounting Officer will be able to fulfil this duty when no information is provided to the department on local body VfM.

\(^{24}\) Q 571
\(^{25}\) Q 574
\(^{26}\) Q 575
\(^{27}\) Q 637
achievements, audit of accounts, or implementation of major initiatives (for example IFRS). Currently, the Audit Commission collects and analyses this information to provide Parliament with assurance through an annual report.

24. Several witnesses identified a critical department level “accountability gap” in the new regime which, unless it is addressed as a matter of urgency, would mean that there would be no mechanism within the draft Bill to assure the Accounting Officer and, in turn, Parliament that public money was being spent appropriately.

25. Under the proposed new arrangements it is unclear how Accounting Officers or Parliament will obtain assurance that the audit regime is performing effectively and that the approximately £200 billion spent by local bodies annually has been used effectively. We recommend that, as part of the new arrangements, a publicly accessible register be established by DCLG which identifies when a body has not appointed an auditor, when local bodies produce their accounts late and identifies where the auditor’s opinion on the financial statements or value for money conclusions was qualified. In addition to the publication of this information, analysis should be undertaken to provide departmental Accounting Officers with meaningful conclusions. The Bill should impose a duty on the Secretary of State to identify which organisation will be responsible for maintaining the register, and for performing the appropriate analysis.

Data matching and the National Fraud Initiative

26. The Audit Commission Act 1998 enables the Audit Commission to require data to be provided by local bodies for the purpose of data matching. The Audit Commission exercises these powers through a data-matching service for local public bodies called the National Fraud Initiative (NFI). The Audit Commission’s anti-fraud and corruption work has identified £919 million of local authority fraud, errors and overpayments since 1996. While Clause 84 of the draft Bill allows the Secretary of State to conduct data matching exercises or arrange for them to be conducted on his behalf, the draft Bill does not make clear which body would carry out data matching services following the abolition of the Audit Commission.

27. The C&AG commended the NFI and stated that he was keen to see it relocated to an appropriate body but, concomitantly, made it clear to us that he considered an executive body to be best placed to take responsibility for the initiative. The National Fraud Authority (an executive agency of the Home Office), the Department for Work and Pensions and the Cabinet Office (ERG) have each expressed an interest in taking on operational ownership of the NFI. We were encouraged to hear that Government values the National Fraud Initiative (NFI) and recognises that a suitable home must be found for

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28 Q 405
29 Written evidence from the Audit Commission
30 Draft Local Audit Bill, Cm 8393, July 2012, p 155
31 Draft Local Audit Bill, Cm 8393, July 2012, p 14
32 Q 632
33 Draft Local Audit Bill, Cm 8393, July 2012, p 14
We further welcome the Secretary of State’s invitation to recommend a body to take on responsibility for the NFI.

28. We recommend that the Cabinet Office takes on responsibility for the NFI. The Government must identify where the NFI will be located on the face of the Bill to Parliament.

29. The Secretary of State should provide the House with clarification on the wording of clause 84(2), 91(1) and 91(3) and should provide evidence to assure the House that the clause would not allow data to be used beyond the remit of identifying fraud. We recommend that all possible uses of the NFI should be set out on the face of the Bill and that any amendments should be made by primary legislation.
3 Independence: appointment and removal of Auditors

Principles of public audit

30. Independence has been a core value guiding the audit of local bodies responsible for public funds in England for the last 150 years. Indeed, it was the perceived need for a more independent audit regime that inspired the Government to establish the Audit Commission in 1983. Lord Heseltine argued that in instances where “local authorities appoint their own auditors, audit is not seen to be obviously independent of local government”. Lord Sharman’s 2001 report has since reiterated the importance of independent audit and independent appointment. While the Communities and Local Government Select Committee explored the principle of independence in detail, we have focused on whether the mechanisms in the draft Bill adequately safeguard the independence of audit for local bodies.

Auditor appointment

31. The Government acknowledges that “independence is a key principle of public audit” and states that “safeguarding independence during the process of appointing an auditor is vital”. In order to safeguard independence, Clause 11 of the draft Bill sets out a requirement for local bodies to take into consideration the advice of an independent auditor panel (“auditor panel”) before appointing an auditor. The local body would not be bound by the audit panel’s recommendations; the draft Bill stipulates only that their advice is sought. Moreover, the draft Bill makes provision for local bodies to nominate their existing audit committees provided that they meet the independence criteria established for the auditor panels. Furthermore, there is scope within the draft Bill for separate local bodies to share an auditor panel and jointly procure audit.

32. In terms of constitution, according to Clause 12 of the draft Bill, auditor panels must consist of a majority of independent members and must have an independent chair. Moreover, the draft Bill stipulates that in order to be considered independent, a panel member must not have been a member or officer of the audited body within the previous five years and must not, at that time, be a relative or close friend of a member of the body.

33. All witnesses agreed that independence is fundamental to a successful audit regime. The Government’s intention in the draft Bill to allow public bodies to appoint their own auditors has proved to be a controversial issue throughout our inquiry. The majority of our witnesses raised specific concerns about the auditor panels. Professor Heald, University of

35 Communities and Local Government Committee, Fourth Report of Session 2010-12, Audit and inspection of local authorities, HC 763, para 27
36 HC Deb, 18 January 1982, col 53
38 Draft Local Audit Bill, Cm 8393, July 2012, p 7
Aberdeen, described them as a “crazy idea”. Both the Audit Commission and the LGA suggested that the proposals would not be practicable because some authorities would struggle to recruit a sufficient number of independent persons; the LGA went as far as to recommend that the proposals should be deleted from the Bill. The Associated Chartered Certified Accounts (ACCA) argued that auditor panels would duplicate and confuse existing governance mechanisms within local bodies (for example scrutiny and audit committees).

34. The proposals within the draft Bill seek to reach a compromise between ensuring the independence of audit and furthering the Government’s localism agenda. In terms of ensuring the independence of audit, witnesses argued that central procurement is the stronger option, whereas in terms of fulfilling the Government’s commitment to localism local appointment would be the more appropriate approach. Some of our witnesses, including Professor Heald and Lord Heseltine, expressed strong opposition to local auditor appointment and insisted that it would be preferable to retain a central capacity to procure audit. Other witnesses argued that the provisions in the draft Bill could be made practicable by replacing the provisions for auditor panels with a requirement to strengthen existing audit committees within local bodies.

Retaining a capacity for procuring audit

35. We heard strong arguments for the retention of a central procurement capacity and were informed that, to date, national procurement has been an effective way of appointing auditors. In particular, witnesses emphasised how the Audit Commission’s unique twin powers relating to the procurement of audit and the appointment of auditors enabled it to negotiate a reduction of 40% in audit fees during the Commission’s 2012 procurement exercise.

36. Witnesses noted that the Commission’s “Post Office” approach to pricing ensured that bodies of similar size pay the same fees which benefited the sector as a whole. Here the Commission’s ability to appoint auditors directly to bodies avoided some of the independence issues which could arise where auditors are locally appointed. For example, the Audit Commission currently avoids conflicts of interest by ensuring that firms were not appointed to bodies with which they shared a significant existing business relationship. In the absence of a central procurement capacity witnesses were concerned that there would be greater variation in fees and audit quality; while larger authorities might

39 Q 107
40 Q 2 & Written evidence from the Local Governance Association
41 Written evidence from the Local Governance Association
42 Written evidence from the Association of Chartered Certified Accountants (ACCA)
43 Q 426
44 Q 106
45 Q 475
46 Q 425
47 Q 462
48 Q 87
experience reductions in audit fees, smaller and more geographically remote authorities are likely to experience rising audit fees (see chapter 7).49 Overall, some form of national (or regional) procurement capacity for audit appointment remained a preferred option for most of our witnesses. We heard evidence that while larger bodies might benefit from local appointment, other bodies might find the cost of the process disproportionate and administratively burdensome. Joanna Simons, Chief Executive of Oxfordshire County Council, stated that even large local authorities might find the proposals for local appointment difficult to put into practice. She told us that recruiting just one suitable independent member for Oxfordshire’s audit committee had been “hard going” and suggested that other bodies might encounter greater difficulty.50 Recruiting additional independent members for auditor panels might prove especially difficult when existing audit contracts expire at the same time and a substantial number of local bodies will therefore be required to procure audit over the same period. Gareth Davies, a Partner at Mazars LLP, told us that this “congestion” in the audit market might be alleviated if local bodies were “given the ability to roll forward their existing audit appointment for a limited time period”.51

37. Given the potential problems associated with local appointment, we recommend that a capacity is retained whose functions are limited to the procurement of audit.

**Strengthening Audit Committees**

38. Should the Government retain its commitment to local auditor appointment, we heard that the current proposals for auditor appointment in the draft Bill could be improved by replacing auditor panels with a statutory requirement for local bodies to form strengthened audit committees.

39. Replacing the provisions in the draft Bill for auditor panels with a requirement for strengthened audit committees would ensure that existing governance arrangements within local bodies do not become confused and duplicated in the new regime. It would also make the proposals for local authorities consistent with health bodies. The Department of Health has recently announced that rather than using auditor panels, health bodies will appoint auditors using their audit committees.52 There is a statutory requirement for health bodies to form an audit committee. This is not the case for local authorities, although the LGA informed us that 80% of local authorities have an audit committee in some form.53 We received evidence that existing audit committees could be strengthened and independence could be safeguarded by:

a) Placing a statutory requirement on local bodies to have an audit committee

b) Prescribing that the chair should be an independent person, and

c) Ensuring that the majority of members are independent.

49 Q 463
50 Q 153
51 Written evidence from Mazars LLP
52 Written evidence Department of Health
53 Written evidence from the Local Government Association
40. Witnesses also argued that the directly-elected and thus political nature of local government requires that further measures should be taken to ensure independence of audit appointment.\textsuperscript{54} The C&AG suggested that a ‘double lock’ mechanism was a “sensible one” for auditor appointment.\textsuperscript{55} Others indicated that this might be difficult to put into practice and offered a “more pragmatic solution” whereby the audit committee should make a recommendation to the full council or equivalent governing body.\textsuperscript{56}

41. Should the Government persist with its proposals for local auditor appointment, we recommend that the draft Bill is amended so that the provisions for auditor panels are replaced with a statutory requirement for strengthened audit committees which have an independent chair and a majority of independent members. We also recommend that, in order to safeguard the independence of audit, the Bill stipulates that full councils, or the equivalent governing body, should appoint auditors following recommendations from their Audit Committee.

**Joint Procurement Arrangements**

42. Witnesses suggested that local bodies could achieve economies of scale in the new regime by jointly procuring audit. For example, the National Association of Local Councils (NALC) and Society of Local Council Clerks’ (SLCC) have proposed a sector-led body to undertake the procurement of audit services for smaller bodies.\textsuperscript{57} Similarly, the LGA suggested that a body, perhaps the LGA itself, could instigate a sector-led approach for procuring audit for local authorities.\textsuperscript{58} We also heard from Stephen Hughes, Chief Executive of Birmingham City Council, who suggested that larger bodies might be willing to invite smaller bodies to enter into a framework agreement with surrounding authorities so that economies could be made on tendering costs for smaller organisations.\textsuperscript{59} There is also scope within the Bill for separate bodies from different sectors, for example Health and local authorities to share an audit committee and jointly procure audit to ensure that the tendering process for local bodies does not become administratively burdensome or excessively costly.

43. We welcome the NALC/SLCC’s proposal for bulk procurement of audit and are pleased to see that Government has registered its support for their initiative. Should the Government remain committed to local appointment of auditors, we recommend that local bodies are encouraged to jointly procure auditors where it is possible to do so, and establish framework agreements where appropriate, in order to achieve economies of scale and value for money in audit procurement. The Bill should provide for maximum flexibility in order to enable local bodies to undertake a variety of joint procurement arrangements.

\textsuperscript{54} Q 469  
\textsuperscript{55} Q 571  
\textsuperscript{56} Q 27  
\textsuperscript{57} Written evidence from the Society of Local Council Clerks  
\textsuperscript{58} Q 155  
\textsuperscript{59} Q 176
Strengthening proposals for the Police

44. We heard concerns that Clause 9 of the draft Bill fails to provide sufficient mechanisms to safeguard the independence of Police audit. The draft Bill states that a Chief Constable should not appoint an auditor. Instead the Police and Crime Commissioner (PCC) is empowered to appoint an auditor for both the PCC and the police in their area. Notwithstanding the existence of Police and Crime Panels, clause 9(4) states that the PCC should consult the auditor panel although the PCC would not be not bound by its advice. We are concerned that this provision places too much unchecked responsibility into the hands of the PCC and that it ignores the accountability frameworks recently established by the Government for the Police. Furthermore, Tom Winsor, Her Majesty’s Chief Inspector of Constabulary, argued that HMIC should be able to exercise a veto power to ensure that police bodies were not overburdened with data requests as a result of the C&AG’s VfM work. HMIC was awarded a power of veto in the Police Act 1996; however, the power has never been used.

45. We recommend that Police and Crime Commissioners should appoint or dismiss auditors after consulting its Police and Crime Panel instead of a separate auditor panel. In instances where two thirds of its members vote to do so, the Police and Crime Panel should be able to veto the Police and Crime Commissioner’s decision. The Police and Crime Commissioner should only be able to appoint or dismiss an auditor once agreement has been reached with the Police and Crime Panel. Moreover, we are convinced that HMIC no longer requires a veto power in respect to audit and inspection of the police given that the Audit Commission’s role is coming to an end.

Managing outstanding audit contracts

46. The draft Bill does not make clear which body will become responsible for contracts agreed by the Audit Commission which conclude after its abolition. Many of our witnesses identified this as a substantial risk and called on Government to make clear how these contracts would be managed in the new regime. Marcine Waterman, Comptroller of the Audit Commission, described the lack of assurance about the future management of contracts which are worth £89.4 million per year, and expire in 2017 (with the option to be extended until 2020), as “one of our biggest concerns about gaps in the Bill”. We heard evidence that the body exercising the central procurement capacity could become responsible for managing outstanding audit contracts which extend beyond the Audit Commission’s abolition. Central appointment of auditors would also negate some of problems with respect to removal of auditors which are outlined later in this Report.

47. Given the potential problems associated with many hundreds of separate procurement processes, we recommend that the Government reconsider the current

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60 Clause 9(2)
61 Clause 9(3)
62 Q 501
63 “Audit Commission will reduce audit fees by 40 per cent”, Audit Commission, 5 March 2012, www.audit-commission.gov.uk
64 Q 71
proposals in the draft bill for the local appointment of auditors and retains a capacity limited to the procurement of audit. The Government should identify which body will become responsible for managing outstanding contracts on the face of the Bill. If a capacity is retained for procuring audit, this capacity should also be responsible for administering outstanding audit contracts. We recommend that the NAO is well placed to take on this responsibility.

Auditor removal

48. Currently the Audit Commission removes or reappoints an auditor where appropriate. The resignation and removal of auditors is provided for in Clause 17 of the draft Bill but will be heavily shaped by subsequent regulations. In the private sector, removal of an auditor is considered to be a serious matter and a report is made directly to the shareholders.

49. The draft Bill states that in cases where the auditor is dismissed, the audited body is required to provide a statement outlining the reasons for dismissal and give notice of its intent to remove the auditor to both the auditor panel and the auditor. The auditor would be entitled to respond to that statement and the auditor’s response should be considered by the auditor panel. Under the provisions in the draft Bill, it is ultimately the audited body’s decision whether or not to terminate the appointment but it must give consideration to the advice of the auditor panel. We heard evidence that the draft Bill does not provide clear and incontestable protections for assuring the independent of Audit Committees and audits.65

50. We recommend that the decision to remove an auditor should only be made by the audit committee in agreement with full council or the relevant governing body. This would provide a “double lock” and ensure that neither body could dismiss an auditor without the agreement of the other.
4 Public Interest Reporting and Whistleblowers

51. Vernon Soare, Executive Director, Professional Standards, Institute of Chartered Accountants in England and Wales (ICAEW), argued that ‘with some further work, [the draft Bill] can work in what one might call “the normal circumstances”’. However, he continued, “we are not quite so sure that, at the moment, it actually caters for extreme or difficult circumstances where allegations of malpractice are alleged”.

Public interest reporting

52. Public interest reports (PIR) are currently produced by an auditor where there are grounds for suspecting that a public body has misspent substantial amounts of money through poor governance or has acted outside its legal powers. During our inquiry we were keen to gain assurance that the proposed mechanisms in the draft Bill for public interest reporting (PIR) and whistleblowing would be sufficient to ensure that the proposed audit regime would operate effectively in those situations.

53. The Secretary of State’s asserted that PIRs on principal bodies are a “very rare thing”. We also heard that PIRs are a vital element of public sector audit and an essential tool in holding public bodies to account and, as such, the Government should ensure that the Bill makes the mechanisms for Public Interest Reporting absolutely clear and provide audit firms with confidence that they will be appropriately remunerated should they encounter a situation where it is necessary to issue a report in the public interest.

54. The CLG Select Committee reported that 131 PIRs were issued between 2002 and early 2011. According to that Committee, many of these PIRs were issued in response to the non-publication of accounts by parish councils; it is likely that the majority of these authorities would receive only a limited assurance audit or no audit at all in the proposed regime.

55. PIRs have also been issued in high profile and controversial cases involving vast sums of public money and serious governance issues. The most protracted, high-cost and high-profile case was the report of the district auditor into Westminster City Council which concluded that senior councillors had misused public money by selling council homes in order to influence voting patterns. The case took 14 years (from 1987-2001) to resolve and was finally settled in the House of Lords on appeal by the Audit Commission. More recent examples of governance failures occurred in Doncaster (2008) and the Wirral (2012).

66 Q 386
67 Q 647
68 Communities and Local Government Committee, Audit and inspection of local authorities, para 41
69 For example, Lincolnshire county Council (2002), Merseytravel (2008), Doncaster (2008) and Wirral Council (2012).
70 Communities and Local Government Committee, Audit and inspection of local authorities, para 41
56. Although, as the Secretary of State argued, there are more tools available to individuals including Freedom of Information requests to hold officials to account, and local government is more transparent than it was at the time of the Westminster case, the majority of witnesses were convinced that PIR remains a fundamental way of holding those responsible for public funds to account.

57. Previously the Audit Commission has acted as a “sounding board” for auditors considering issuing a PIR and provided an indemnity to firms should they face litigation. CIPFA Chief Executive Steve Freer told us that the Commission’s functions in this regard were valued and well-respected.\(^{71}\) Under the proposals in the draft Bill an auditor must consult the audited body’s auditor panel before issuing a PIR and there is no mechanism for providing indemnification.

58. Some witnesses stated that the auditors’ professional standards and regard for their reputation would ensure that a PIR would be pursued where necessary in the majority of cases. However, Gareth Davies of Mazars LLP warned us that a system of local appointment of audit “puts the auditor in a more exposed position—particularly as currently drafted—when things get very difficult”.\(^{72}\) Lord Heseltine argued that a pressure to be reappointed and a fear of being branded with a reputation for being a “difficult firm” might compromise the auditor’s independence which, in turn, could mean that they would be less likely to issue a PIR.\(^{73}\) It is worth noting that no PIR has been raised with respect to Foundation Trust (FT) hospitals since these bodies have had the power to appoint their own auditors despite a number of well-publicised instances of serious financial and governance problems.\(^{74}\)

59. In addition, the draft Bill requires the auditor to consult the audited body’s auditor panel if there is an expectation that additional work is required in the public interest. Our witnesses were in agreement that the auditor must be free to pursue a line of investigation regardless of whether or not the auditor panel or audit committee agrees.\(^{75}\) Furthermore, witnesses agreed that the draft Bill lacked a clear mechanism to ensure that the auditor is appropriately recompensed for the costs, including additional work, associated with a PIR,\(^{76}\) a role currently undertaken by the Audit Commission.

60. We consider auditor independence to be vital. We recommend that the Bill should include provision for an auditor to raise a Public Interest Report (PIR) without prior reference to the audited body’s auditor panel or audit committee. The draft Bill should be amended to enable the National Audit Office to provide advice and support to auditors, if necessary, before a PIR is issued and throughout the PIR process. The Bill, when presented to Parliament, should place a duty upon auditors to inform the Secretary of State of circumstances where they have a concern about serious governance and financial failure.

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\(^{71}\) Q 377

\(^{72}\) Q 426

\(^{73}\) Q 479

\(^{74}\) Q 265

\(^{75}\) Q 37

\(^{76}\) Qq 386, 427
61. We consider that the lack of a clear mechanism to ensure that an auditor is appropriately recompensed for costs associated with a PIR to be potentially dangerous omission. We call on the Department for Communities and Local Government to make clear future arrangements for indemnifying bodies and suggest that it would be appropriate for the DCLG to seek advice from the C&AG prior to issuing any indemnities.

Whistleblowers

62. We recognise that in many instances, serious cases of financial or governance failure are not identified through audit itself but are brought to the attention of the appropriate authorities by individual whistleblowers. Currently the Audit Commission and its appointed auditors are both identified as prescribed persons.  

77 The Audit Commission also operated a hot line for whistleblowers. Witnesses argued that with the abolition of the Audit Commission there is a real risk that responsible workers who witness wrongdoing may not feel comfortable approaching a private auditing firm that has a commercial relationship with the local body or council. A possible consequence of this is that a worker may believe that the only option they have is to raise the concern with the media or to leak information anonymously. The other possible consequence is that the whistleblower may remain silent, an even more undesirable outcome. The C&AG told us that in this context he would be willing to fulfil a ‘backstop’ role but said that he would require additional powers to instruct auditors to undertake appropriate investigations in response to the whistleblower’s information.78

63. We strongly recommend that in addition to the appointed auditor, the C&AG should also be named as a prescribed person in the Bill. The C&AG should continue to offer a hot line for whistleblowers and be given power to instruct auditors to investigate whistleblower’s information.

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78 Q 571
5 Value for Money Studies (VfM)

64. In 2010, prior to the publication of the draft Bill, the Government decided to terminate the Audit Commission’s Comprehensive Area Assessments. The draft Bill removes the Audit Commission’s statutory duties in relation to undertaking or promoting Value for Money (VfM) studies. In the future the Government expects the National Audit Office “will undertake a small number of additional value for money studies each year, with a focus on sector wide systemic issues and end to end scrutiny”. The draft Bill expects that sector specific bodies including the LGA, HMIC and Monitor, will lead performance improvement for bodies in their respective sectors.

The Audit Commission’s Value for Money work

65. Lord Heseltine, the architect of the Audit Commission, considered VfM studies to be one of the founding rationales for the creation of the Commission and an integral tool for measuring the efficiency and effectiveness of local bodies. According to Lord Heseltine:

The work that the Audit Commission did in value-for-money studies created massive economies, and benefits therefore, simply by turning a spotlight on what you could achieve in a well-run authority. It has elevated the practice of the best to a standard that others could copy.

66. However, we also heard evidence that the nature of the Commission’s VfM work had changed. Witnesses argued that while larger national studies which were perceived to have had “a lot of value in terms of efficiency and effectiveness across local authorities”, they had been superseded by the Comprehensive Area Assessment which local authorities, in particular, judged to be less effective.

67. A number of Witnesses argued that the CAA had become unwieldy, poorly reflected local priorities and that the studies had increased in volume but declined in quality. Joanna Simons, Chief Executive of Oxfordshire City Council told us that there had been too many reports of insufficient quality. Similarly, Stephen Hughes, Chief Executive of Birmingham City Council, argued that some of the Commission’s work “was really very good, but quite a lot of the studies they did were useless”. Moreover Joanna Simons told us that for most local authorities “the worry is about being inundated with endless requests for additional data for things that feel like a long way from our priorities”. She argued that:

79 Draft Local Audit Bill, Cm 8393, July 2012, p 165
81 Q 477
82 Q 391
83 Q 200
84 Q 198
the problem with the Audit Commission [was that] it just got out of control in terms of the latest idea that might be fine in “X” part of the country but wasn’t relevant for us.85

68. The Secretary of State reinforced this argument and told us that he was not convinced that the Audit Commission “really added to that process of producing value for money”.86

69. The scope of the Audit Commission’s work on VfM expanded over time at the request of the Government. While we received conflicting evidence about the value of the Audit Commission’s work in this area, we are disappointed that the Government failed to undertake a review of the Commission’s Value for Money work prior to its termination.

70. We are very concerned that the draft Bill makes no provision for comprehensive like-for-like value for money comparisons which would enable informed judgements about whether taxpayer money had been spent effectively. The Bill should be redrafted to include a systematic process to enable benchmarking and like-for-like comparisons between public bodies in the new regime.

The National Audit Office and national VfM studies

71. The NAO currently undertakes approximately sixty VfM studies per annum.87 Amyas Morse, C&AG, told us that he intends to undertake a further six in response to the additional responsibilities conferred on the NAO in the draft Bill; he referred to these pieces of work as the “devolved and local space” studies. The C&AG expected the NAO to undertake studies across local authorities, the Constabulary and health bodies.88 These studies would, he argued, differ from the inspection work undertaken by the HMIC and Monitor as it would focus on broader systemic issues.

72. Some witnesses questioned whether the NAO had the expertise and experience to perform its new role, arguing that an opportunity has been missed to transfer remaining expertise from the Audit Commission to the NAO.89 However, the C&AG said he had already recruited of additional staff members90 and he was confident that the NAO was in a strong position to undertake the work with the resources he has already requested which amount to “roughly a 10% uplift in resources”.91 We note the C&AG’s confidence that the NAO will be capable of undertaking the additional VfM work imposed by the draft Bill. The C&AG should monitor closely whether he has sufficient resources to meet this requirement and, if necessary, request additional resources from the Public Accounts Commission to discharge his new responsibilities.

85 Q 198
86 Q 655
87 Communities and Local Government Committee, Audit and inspection of local authorities, p 35
88 Q 597
89 Q 390
90 Q 585
91 Q 594
73. A number of witnesses argued that limiting the number of devolved and local space studies to be undertaken by the NAO to six was arbitrary; and that the C&AG should be able to undertake further studies where he deemed it necessary. The C&AG told us that he would be content for the NAO to take on more VfM studies should it “become obvious that we need to do more” but warned against a situation where the NAO would be “covering areas that were not envisaged originally”.

74. The C&AG told us he was committed to the NAO maintaining a close working relationship with the LGA. The NAO currently consults the LGA on the topics for the VfM studies undertaken by the NAO through a reference panel chaired by the Chief Executive of the LGA, Carolyn Downs. While the LGA offers the NAO “considerable guidance” on its approach it is important to stress that the C&AG should take final decisions regarding the six VfM studies.

75. Some of our witnesses were concerned about the way in which topics would be selected for VfM studies. Gillian Fawcett of ACCA questioned whether the reference panel would choose to address some of the “wicked issues”, which are usually complex or intractable problems which require monitoring. The Audit Commission currently addressed these difficult issues through their studies by drawing on a national picture in order to make suggestions for improvement nationally and on a local level. It was not clear whether the C&AG would continue this practise.

76. We recommend that the C&AG consult widely in order to identify the core issues which need to be addressed by its six Value for Money Studies. We expect the C&AG to work closely with the Committee of Public Accounts in developing its expanded VfM programme.

77. A number of witnesses were concerned about the C&AG’s ability to access sufficient high quality data in order to make powerful VfM conclusions. Other witnesses argued that the C&AG’s detailed guidance published alongside the Code (see Chapter 2) would ensure that data is collected in comprehensive and consistent fashion. Moreover, it was also recognised that some of the valuable data and information currently collected by the Audit Commission might be lost in the new regime. An example given was the Audit Commission’s unique relationship with the auditors allowed it to survey auditors for information outside of the Code for no additional cost as this work was funded through the

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92 Q 594
93 Q 240
94 Q 590
95 Q 203
96 Q 573
97 Q 392
Audit Commission’s “top slice”.99 This arrangement allowed the Audit Commission to produce reports on local council financial resilience and make conclusions about how many councils struggled to cope with cuts to resources rather than naming them individually.100 There is no mechanism in the draft Bill to continue this arrangement; any additional work would have to be commissioned separately at an additional cost to the C&AG.

78. We recommend that the Bill include a provision to confer on the C&AG an additional power to instruct auditors to collect consistent information on his behalf. The Secretary of State should provide detail on how auditors will be reimbursed for this additional work.

Sector-led performance

79. Alongside the NAO’s six national VfM studies, the Government invites “the sectors themselves” to play “a greater role in improvement activity”.101 According to the Government, this would ‘enable a greater focus on issues the sectors consider will be able to add greatest value’.102 During our inquiry we heard evidence from Monitor and HMIC about their approach to inspection and improvement as well as evidence from the LGA about its newly instituted sector led-approach to performance management. The LGA’s approach, which predominantly consists of a peer challenge process103 and an online data and benchmarking service called LG Inform, was of particular interest to us.

80. We heard conflicting evidence about whether, in principle, a sector-led approach is the most appropriate way to address improvement issues in local bodies. The C&AG argued that “there is nothing wrong at all with the LGA being seen in the role of encouraging and driving improvement”104 but cautioned that he would want to investigate any cases where the NAO’s findings contradicted the LGA’s work.105

81. However, other witnesses argued that a body representative of the taxpayer rather than the LGA, which is a membership organisation representative of local government, should be responsible for this work, due to the substantial funds that local authorities receive from central Government via taxpayers.106 We are concerned that as a result of the draft Bill there a vacuum surrounding Value for Money work for individual local bodies which sector led organisations, including the LGA, are expected to fill. This places a substantial amount of responsibility on the LGA which is essentially a membership organisation and is primarily accountable to its members, rather than directly to the taxpayer.

99  Q 52
101  Draft Local Audit Bill, Cm 8393, July 2012, p 165
102  Draft Local Audit Bill, Cm 8393, July 2012, p 165
103  Written evidence from the Local Government Association
104  Q 590
105  Q 590
106  Q 490
82. Witnesses gave mixed opinions about the effectiveness of a sector-led approach to improvement. While some witnesses suggested that a sector-led process could provide more targeted information to local bodies which better suits their needs, others doubted that such an approach would prove sufficiently robust because the LGA cannot compel its members to collect information in a standardised format.\[^{107}\] We consider that the effectiveness of the LGA’s peer-led improvement work is undermined by that organisation being a membership body, and the absence of a formal mechanisms to identify poorly performing local authorities who may, or may not, choose to participate.

83. Despite this we are encouraged by the progress that the LGA has made with regard to its sector-led approach and it is reassuring to hear that the C&AG is satisfied with the LGA’s methodology. Furthermore, we are encouraged that, from mid-2013 the public will be able to use the LG Inform tool to compare the performance of their local authority to others and hold the executive to account. We recommend that the NAO should undertake a review of the effectiveness of the LGA’s sector-led approach one year from the commencement of the scheme.

\[^{107}\] Q 186
6 Audit fees and the market in audit

84. According to the Government one of the key objectives of the draft Bill is to achieve lower audit fees through a competitive market in audit.\(^{108}\) The impact assessment accompanying the draft Bill concludes that the current arrangement of central procurement of audit “does not include strong incentives for costs to be minimised”\(^{109}\) The Secretary of State argued that, under the auspices of the Audit Commission, “local authorities had been overcharged for their audit function”.\(^{110}\) Consequently, and as an interim step towards abolition, the Government asked the Audit Commission to outsource the work of its in-house practice with effect from 2012/13, under its existing powers.\(^{111}\)

85. In its latest procurement exercise the Audit Commission reduced fees by 40% on 2011/12 levels. Part of this saving resulted from the decision to end its assessment and inspection functions and its ability to negotiate bulk contracts on behalf of local bodies. However, the Audit Commission told us that these savings were not attributable to these factors alone; in addition the Audit Commission argued that they were made possible due to the Audit Commission’s “twin powers of being able to impose and appoint the auditors”.\(^{112}\) These twin powers enabled the Audit Commission to operate what it termed a “Post Office” equalisation approach to pricing whereby Audit Firms were offered large contracts which contained a mixture of desirable and less desirable bodies to audit.

86. Witnesses representing local authorities said that the Audit Commission had been successful in identifying savings in audit fees. For example Joanna Simons, Chief Executive of Oxfordshire County Council, noted that “one of the good things in the past few years has been the downward pressure on audit fees”.\(^{113}\) The impact assessment notes that it is difficult to predict what impact the unwinding of this system will have on the level of audit fees in the new regime.\(^{114}\)

Variation in audit fees

87. The majority of our witnesses argued that there would be substantial geographical variation in fees between different local bodies in the new regime.\(^{115}\) According to Michael O’Higgins, former Chief Executive of the Audit Commission:

Very large or attractive authorities—the Birminghams and the Westminsters—may well be able to get quite good deals, but there will be many smaller and more remote

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\(^{108}\) Draft Local Audit Bill, Cm 8393, July 2012, p 6  
\(^{109}\) Draft Local Audit Bill, Cm 8393, July 2012, p 152  
\(^{110}\) Q 671  
\(^{111}\) Draft Local Audit Bill, Cm 8393, July 2012, p 159  
\(^{112}\) Q 95  
\(^{113}\) Q 176  
\(^{114}\) Draft Local Audit Bill, Cm 8393, July 2012, p 154  
\(^{115}\) Q 463
authorities that will not benefit from the sort of Post Office pricing that the Commission carries out.\textsuperscript{116}

Sir Robert Naylor, Chief Executive of the University of London’s Hospital (UCLH) NHS Foundation Trust informed us that the audit fees that UCLH currently pay are “about half” of what it previously paid to the Audit Commission.\textsuperscript{117} This reduction in fees can, in part, be attributed to differences between the Audit Commission’s and Monitor’s Code; the latter’s Code of Practice does not provide for VfM studies and is narrower than the Audit Commission’s.

88. We heard contrary evidence regarding whether fees are likely rise or fall overall compared to current rates. A minority of our witnesses, including Paul Woolston of PwC, suggested to the Committee that “fees will come down across the board, including smaller organisations”.\textsuperscript{118} Conversely the majority of our witnesses, including Grant Thornton, argued that “it is likely that fees will increase, not decrease, as a result of the draft Bill”.\textsuperscript{119} The possibility of increased audit fees were cited by Steve Parkinson, Society of Local Council Clerks, who suggested that when “we get to the 2017 tender exercise, I cannot imagine those fees going down, and especially for the smallest, I can see them needing to go up”.\textsuperscript{120}

89. Sarah Howard, Head of Public Sector Assurance at Grant Thornton LLP, also told the Committee that “there will be pressure on fees in the absence of large volume contracts and the huge discounts” that they are currently able to offer. This, she argued, is due to the loss of efficiencies in procurement costs, increases in tendering costs and the loss of the Audit Commission’s indemnity function.\textsuperscript{121} The draft impact assessment highlights fourteen potential drivers of local bodies’ audit fees, some of which may act as upward pressures, others as downward pressures, and others with unidentifiable effect.\textsuperscript{122}

90. While we recognise that there would be scope for achieving economies of scale through joint procurement in the new regime, we also consider that substantial economies could be realised through central purchasing and appointment. This reinforces our view that a central procurement capacity should be retained. However, should the Government maintain its commitment to local appointment, we recommend that local bodies be encouraged and supported in jointly procuring audit in an effort to secure more competitive fees than could be achieved if each individual body appointed its own auditor. We consider the LGA to be well placed to potentially play an active role in facilitating this process.

\textsuperscript{116} Q 94  
\textsuperscript{117} Q 300  
\textsuperscript{118} Q 464  
\textsuperscript{119} Written evidence from Grant Thornton LLP  
\textsuperscript{120} Q 238  
\textsuperscript{121} Qq 463-464 & Written Evidence from Grant Thornton LLP  
\textsuperscript{122} Draft Local Audit Bill, Cm 8393, July 2012, p 18
91. Given the uncertainties surrounding the level of future audit fees, we recommend Government conduct a post-implementation review following both the first and second self-appointment exercises.

The audit market

92. The Government assumes that a more competitive market in audit will be established as a result of the implementation of the draft Bill and, in turn that a more competitive market will lead to a downward pressure on audit fees. The Government argues that audit firms will “benefit from the opening up of the audit market to competition, as they will have increased opportunity to realise profits”.123

93. On the other hand, Grant Thornton told us that the draft Bill would not promote competition. Indeed, they suggested that the opposite is likely;124 telling us that “the impact assessment of the draft Bill is flawed in that there is already full competition with 100% of audits outsourced. The outsourcing followed a competitive process with commercially attractive ‘lots’ to attract potential new entrants to the market”.125 Only two new entrants were awarded contracts during the last procurement exercise.

94. When it considered this matter, the Communities and Local Government Select Committee recommended that a stand-alone company, preferably a mutual, should be established to capture the Audit Commission’s skills and expertise.126 The DA Partnership, named after District Audit (the forerunner to the Commission), was temporarily established as part of a mutual partnership. If successful in the bidding process, it was expected that the partnership would transfer staff from the Audit Commission under TUPE regulations.127 However, the DA Partnership were awarded only one contract, and “the partnership could not launch as an employee-owned independent firm. Instead it became a wholly-owned subsidiary of Mazars, trading as Mazars DA”.128

95. We heard evidence to suggest that it is not realistic for smaller firms and organisations such as mutuals and co-operatives to bid successfully for one-off audits without an inevitable impact on quality, consistency or cost.129 This, it was argued was because the characteristics and complexity of public sector audit requires auditors to invest in understanding the unique aspects of the public sector audit regime in order to deliver high quality audits. Moreover, it was argued, that the wider scope of audit, public reporting and the relationship with local electors distinguish local authority audit from other audits and audit suppliers therefore use highly specialised and experienced teams. These requirements were cited as likely barriers which would prevent smaller firms from entering the market.

123 Draft Local Audit Bill, Cm 8393, July 2012, p 87
124 Written evidence from Grant Thornton
125 Written evidence from Grant Thornton
126 Communities and Local Government Committee, Audit and inspection of local authorities, para 14
127 “Gareth Davies to head up new audit mutual”, Guardian Professional, 30 September 201,
www.guardian.co.uk/public-leaders-network
129 Written evidence from Grant Thornton
96. We are concerned that the provisions in the draft Bill will not produce an open and competitive audit market as envisaged by the Government which is an aim that we support. The Bill should not result in contracts being awarded to a small number of audit firms. We recommend that the Government consult further appropriate bodies including the Competition Commission, FRC, LGA and professional accountancy bodies in order to amend the Bill so that effective competition can be realised.
7 Conclusion

97. An effective local audit regime is a vital way of providing assurance to both the electorate and Parliament that local bodies are spending public money efficiently. The Government’s proposals represent a radical departure in the way in which the local public audit regime is currently managed. The draft Bill provides local bodies with the authority to appoint their own auditors on the advice of an independent auditor panel and outlines a new regulatory framework which aligns the provisions for local public audit more closely with those for private sector audit. The new audit regime is more complex and fragmented than the current regime where the Audit Commission performs the role of regulator, commissioner and provider of audit. The audit arrangements proposed by Government is workable but the complexity of these proposals exposes a number of gaps and risks which the DCLG must proactively manage in order for the regime to work effectively.

98. The Government must ensure that a mechanism is developed to assure Parliament that public money is delivering value for money and local bodies are practicing sound financial management. The proposals for self-appointment of auditors risk compromising the independence of audit. The Government must intervene to ensure that existing governance structures within local bodies are not duplicated; existing contracts are managed proficiently; economies of scale in audit fees are not lost; quality of audit does not diminish; value for money can be measured comprehensively and consistently; fees, especially for smaller bodies, do not increase as a result of increased tendering costs and potential limitations to the market in audit and; processes for auditor removal, whistleblowing and public interest reporting are rigorous enough so that the regime is sufficiently robust in difficult circumstances.

99. The majority of our concerns would be addressed if a procurement capacity were to be retained within the new regime for this mechanism most effectively safeguards the independence of audit and enables local bodies to benefit from economies in scale. If the Government implements its commitment to local auditor appointment, the current proposals for auditor panels should be replaced by a statutory requirement to strengthen existing audit committees.

100. The Government should be open to our proposals and suggestions for amendments to the Bill to reinforce the independence of audit, the accountability of the tax-payers’ pound and secure competitive audit fees for public bodies.
Conclusions and recommendations

Introduction

1. The Department of Health failed to provide the Committee with appropriate and timely information in advance of our pre-legislative scrutiny of the draft Bill. It is very disappointing that the Department of Health acted in this way. As a result, we have been unable to consider this evidence properly and remain very concerned that proper scrutiny of the audit and accountability arrangements for Health trusts and commissioning groups should be carried out by Parliament. Nevertheless, we welcome the opportunity to look at the draft Bill in general. (Paragraph 5)

2. The Government should include in the impact assessment an assessment of the savings made from abolishing the Audit Commission in its residual form. In order to make accurate assessments of the total savings made by the draft Bill itself, the Government should use figures from 2011/12 as a baseline. Given uncertainties about the figures in the impact assessment and the cost of local body compliance, we recommend that a new financial impact assessment is published alongside the Bill. (Paragraph 8)

3. We are not convinced that subjecting such regulations to negative procedure only is satisfactory; and neither has the Government provided any justification. In the interests of proper Parliamentary scrutiny, regulation should be subject to the affirmative procedure. (Paragraph 9)

The new audit regime

4. We are not convinced that the Financial Reporting Council understands the wider scope of public sector audit. The Government should take appropriate steps to assure Parliament that the Financial Reporting Council, in taking on its new role, reflects the importance and character of public sector audit. The Bill, when presented to Parliament, should also define “major audit” and clarify how the quality of audit for bodies which fall outside this scope will be reviewed. We recommend that the performance of the new regulatory framework should be addressed directly in the Government’s post-implementation review. (Paragraph 17)

5. We recommend that the draft Bill should be amended in order to provide the C&AG with a duty to publish detailed mandatory guidance to accompany the Code and that the C&AG should report annually to Parliament on the effectiveness of the Code. (Paragraph 18)

6. We agree with the C&AG that the DCLG and other departments must engage fully in the new audit process if it is to be effective. In its response to this Report, the Department should set out what steps it will take to achieve this. (Paragraph 21)

7. We recommend that, as part of the new arrangements, a publically accessible register be established by DCLG which identifies when a body has not appointed an auditor, when local bodies produce their accounts late and identifies where the auditor’s...
opinion on the financial statements or value for money conclusions was qualified. In addition to the publication of this information, analysis should be undertaken to provide departmental Accounting Officers with meaningful conclusions. The Bill should impose a duty on the Secretary of State to identify which organisation will be responsible for maintaining the register, and for performing the appropriate analysis. (Paragraph 25)

8. We recommend that the Cabinet Office takes on responsibility for the NFI. The Government must identify where the NFI will be located on the face of the Bill to Parliament. (Paragraph 28)

9. The Secretary of State should provide the House with clarification on the wording of clause 84(2), 91(1) and 91(3) and should provide evidence to assure the House that the clause would not allow data to be used beyond the remit of identifying fraud. We recommend that all possible uses of the NFI should be set out on the face of the Bill and that any amendments should be made by primary legislation. (Paragraph 29)

Independence: Appointment and Removal of Auditors

10. Given the potential problems associated with local appointment, we recommend that a capacity is retained whose functions are limited to the procurement of audit. (Paragraph 37)

11. Should the Government persist with its proposals for local auditor appointment, we recommend that the draft Bill is amended so that the provisions for auditor panels are replaced with a statutory requirement for strengthened audit committees which have an independent chair and a majority of independent members. We also recommend that, in order to safeguard the independence of audit, the Bill stipulates that full councils, or the equivalent governing body, should appoint auditors following recommendations from their Audit Committee. (Paragraph 41)

12. We welcome the NALC/SLCC’s proposal for bulk procurement of audit and are pleased to see that Government has registered its support for their initiative. Should the Government remain committed to local appointment of auditors, we recommend that local bodies are encouraged to jointly procure auditors where it is possible to do so, and establish framework agreements where appropriate, in order to achieve economies of scale and value for money in audit procurement. The Bill should provide for maximum flexibility in order to enable local bodies to undertake a variety of joint procurement arrangements. (Paragraph 43)

Strengthening Proposals for the Police

13. We recommend that Police and Crime Commissioners should appoint or dismiss auditors after consulting its Police and Crime Panel instead of a separate auditor panel. In instances where two thirds of its members vote to do so, the Police and Crime Panel should be able to veto the Police and Crime Commissioner’s decision. The Police and Crime Commissioner should only be able to appoint or dismiss an auditor once agreement has been reached with the Police and Crime Panel. Moreover, we are convinced that HMIC no longer requires a veto power in respect
to audit and inspection of the police given that the Audit Commission’s role is coming to an end. (Paragraph 45)

Managing outstanding audit contracts

14. Given the potential problems associated with many hundreds of separate procurement processes, we recommend that the Government reconsider the current proposals in the draft bill for the local appointment of auditors and retains a capacity limited to the procurement of audit. The Government should identify which body will become responsible for managing outstanding contracts on the face of the Bill. If a capacity is retained for procuring audit, this capacity should also be responsible for administering outstanding audit contracts. We recommend that the NAO is well placed to take on this responsibility. (Paragraph 47)

15. We recommend that the decision to remove an auditor should only be made by the audit committee in agreement with full council or the relevant governing body. This would provide a “double lock” and ensure that neither body could dismiss an auditor without the agreement of the other. (Paragraph 50)

Public Interest Reporting and Whistleblowers

16. We consider auditor independence to be vital. We recommend that the Bill should include provision for an auditor to raise a Public Interest Report (PIR) without prior reference to the audited body’s auditor panel or audit committee. The draft Bill should be amended to enable the National Audit Office to provide advice and support to auditors, if necessary, before a PIR is issued and throughout the PIR process. The Bill, when presented to Parliament, should place a duty upon auditors to inform the Secretary of State of circumstances where they have a concern about serious governance and financial failure. (Paragraph 60)

17. We consider that the lack of a clear mechanism to ensure that an auditor is appropriately recompensed for costs associated with a PIR to be potentially dangerous omission. We call on the Department for Communities and Local Government to make clear future arrangements for indemnifying bodies and suggest that it would be appropriate for the DCLG to seek advice from the C&AG prior to issuing any indemnities. (Paragraph 61)

18. We strongly recommend that in addition to the appointed auditor, the C&AG should also be named as a prescribed person in the Bill. The C&AG should continue to offer a hot line for whistleblowers and be given power to instruct auditors to investigate whistleblower’s information. (Paragraph 63)

Value for Money Studies (VfM)

19. The scope of the Audit Commission’s work on VfM expanded over time at the request of the Government. While we received conflicting evidence about the value of the Audit Commission’s work in this area, we are disappointed that the Government failed to undertake a review of the Commission’s Value for Money work prior to its termination. (Paragraph 69)
20. We are very concerned that the draft Bill makes no provision for comprehensive like-for-like value for money comparisons which would enable informed judgements about whether taxpayer money had been spent effectively. The Bill should be redrafted to include a systematic process to enable benchmarking and like-for-like comparisons between public bodies in the new regime. (Paragraph 70)

21. We note the C&AG’s confidence that the NAO will be capable of undertaking the additional VfM work imposed by the draft Bill. The C&AG should monitor closely whether he has sufficient resources to meet this requirement and, if necessary, request additional resources from the Public Accounts Commission to discharge his new responsibilities. (Paragraph 72)

22. We recommend that the C&AG consult widely in order to identify the core issues which need to be addressed by its six Value for Money Studies. We expect the C&AG to work closely with the Committee of Public Accounts in developing its expanded VfM programme. (Paragraph 76)

23. We recommend that the Bill include a provision to confer on the C&AG an additional power to instruct auditors to collect consistent information on his behalf. The Secretary of State should provide detail on how auditors will be reimbursed for this additional work. (Paragraph 78)

24. We are concerned that as a result of the draft Bill there a vacuum surrounding Value for Money work for individual local bodies which sector led organisations, including the LGA, are expected to fill. This places a substantial amount of responsibility on the LGA which is essentially a membership organisation and is primarily accountable to its members, rather than directly to the taxpayer. (Paragraph 81)

25. We consider that the effectiveness of the LGA’s peer-led improvement work is undermined by that organisation being a membership body, and the absence of a formal mechanisms to identify poorly performing local authorities who may, or may not, choose to participate. (Paragraph 82)

26. We recommend that the NAO should undertake a review of the effectiveness of the LGA’s sector-led approach one year from the commencement of the scheme. (Paragraph 83)

Audit Fees and the Market in Audit

27. While we recognise that there would be scope for achieving economies of scale through joint procurement in the new regime, we also consider that substantial economies could be realised through central purchasing and appointment. This reinforces our view that a central procurement capacity should be retained. However, should the Government maintain its commitment to local appointment, we recommend that local bodies be encouraged and supported in jointly procuring audit in an effort to secure more competitive fees than could be achieved if each individual body appointed its own auditor. We consider the LGA to be well placed to potentially play an active role in facilitating this process. (Paragraph 90)
28. Given the uncertainties surrounding the level of future audit fees, we recommend Government conduct a post-implementation review following both the first and second self-appointment exercises. (Paragraph 91)

29. We are concerned that the provisions in the draft Bill will not produce an open and competitive audit market as envisaged by the Government which is an aim that we support. The Bill should not result in contracts being awarded to a small number of audit firms. We recommend that the Government consult further appropriate bodies including the Competition Commission, FRC, LGA and professional accountancy bodies in order to amend the Bill so that effective competition can be realised. (Paragraph 96)
Formal Minutes

Tuesday 18 December 2012

Members present:

Mrs Hodge, in the Chair

Mr Clive Betts
Meg Hillier
Mark Pawsey

Mark Reckless
Ian Swales
Heather Wheeler

Draft Report (Draft Local Audit Bill: Pre-legislative Scrutiny), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 100 read and agreed to.

Summary agreed to.

Resolved, That the Report be the First 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 (in addition to that ordered to be reported for publishing on 23 October 2012.

[The Committee adjourned.]
Witnesses

Tuesday 30 October 2012

Michael O’Higgins, former Chairman of the Audit Commission and Marcine Waterman, Controller of Audit, the Audit Commission. Ev 1

Robert Black, former Auditor General Scotland; David Walker, former director of public reporting at the Audit Commission; Professor David Heald, Aberdeen University; and Jessica Crowe, Executive Director, Centre for Public Scrutiny Ev 12

Tuesday 6 November 2012

Carolyn Downs, Chief Executive, Local Government Association; Steve Parkinson, National Executive Council Member, Society of Local Council Clerks; Joanna Simons, Chief Executive, Oxfordshire County Council; and Stephen Hughes, Chief Executive, Birmingham City Council Ev 22

Richard Douglas, Director General of Policy, Strategy and Finance, The Department of Health; Professor Peter C. Smith, Imperial College; Sir Robert Naylor, Chief Executive of University College London Hospitals NHS Foundation Trust; and Dr David Bennett, Chief Executive, Monitor Ev 33

Tuesday 20 November 2012

Gillian Fawcett, Head of Public Sector, ACCA; Steve Freer, Chief Executive, CIPFA; Vernon Soare, Executive Director, Professional Standards, ICAEW; and Paul George, Executive Director of FRC Conduct Committee, Financial Reporting Council Ev 45

Paul Woolston, PwC assurance partner, PwC; Sarah Howard, Head of Public Sector Assurance, Grant Thornton UK LLP; and Gareth Davies, Partner, Mazars LLP Ev 53

Lord Heseltine, House of Lords Ev 60

Tuesday 27 November 2012

Tom Winsor, Her Majesty’s Chief Inspector of Constabulary Ev 64

Amyas Morse, Comptroller and Auditor General, National Audit Office Ev 71

Rt Hon Eric Pickles MP, Secretary of State for Communities and Local Government; Brandon Lewis MP, Parliamentary Under Secretary of State, Department for Communities and Local Government Ev 78
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# List of additional written evidence

(published in Volume II on the Committee’s website www.parliament.uk/business/committees/committees-a-z/commons-select/draft-local-audit-bill-ad-hoc-committee)

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Okay. I think that the Government would agree that that mechanism is accountability to local people.

Marcine Waterman: The Government may believe that, but the local bodies are not self-funded, they are funded through a compulsory tax levy and money passed through from central Government, so surely there should be a mechanism to inform both central Government and the taxpayers what has happened to that money. How locally would the public actually be assured that the accounts have been published properly, and the results of the audits? There is no requirement, in essence, for anyone to say who the auditor is and what they have done.

Q3 Chair: Okay. I think that the Government would argue that that mechanism is accountability to local people.

Marcine Waterman: The Government may believe that, but the local bodies are not self-funded, they are funded through a compulsory tax levy and money passed through from central Government, so surely there should be a mechanism to inform both central Government and the taxpayers what has happened to that money. How locally would the public actually be assured that the accounts have been published properly, and the results of the audits? There is no requirement, in essence, for anyone to say who the auditor is and what they have done.

Q4 Ian Swales: There is no requirement to Parliament now is there? Just to clarify that point. We are not talking about changing, are we?

Marcine Waterman: That is quite interesting, because even the PAC’s 28th report talked about the accountability assurance that you get from the Audit Commission and its reports in order for the departmental accounting officer to provide a system statement that the money has been spent for its intended purposes. So, actually, there is indeed a process and mechanism currently.

Michael O’Higgins: And of course the Audit Commission publishes details of who the appointed auditor is for each public body.

Q5 Chair: So is your plea in this—because I slightly took Ian’s point—that there should be publication of who the auditors are on the face of the Bill or in regulations, and a duty to publish the audited accounts on a website or something like that? What is it you want to see that would at least give you the accountability locally? Then we can go on if you are saying that there is no accountability at all. Is it that there needs to be a tightening up of the legislation on publication through duties in the draft Bill or in regulations?

Marcine Waterman: Yes, I would say that there should be a duty both locally and centrally to pull together the results of the audit process, to make the Bill more robust.

Q6 Chair: Just to say to you—Richard Bacon will be better on this than me—those us of who are on the Public Accounts Committee would say that the permanent secretary at the Department for Communities and Local Government—and, indeed, other Departments—remains accountable for the money spent by that Department. So that accountability is still there, however they choose to exercise it. I am right about that, aren’t I?

Mr Bacon: The accounting officer is still accountable to us—that has not changed, that is true.

Marcine Waterman: And how will they get the information?

Q7 Mr Bacon: That is a good question. You have said that there will be no requirement to say who the
auditors are. Are you saying that that information is secret?

Marcine Waterman: I am not saying it is secret. Currently, the Commission publishes it on our website, so that both local people and all parties interested can know who the auditors are and where they come from. There is nothing in the draft Bill that puts a requirement on anyone to publish that information.

Q8 Mr Bacon: So if you are a local authority, say, and you have an auditor, are you saying that there is no requirement for the local authority to state anywhere on its own website who its auditors are?

Marcine Waterman: That is correct.

Q9 Mr Bacon: There is no requirement at all.

Marcine Waterman: Not in the draft Bill at present.

Q10 Mr Bacon: No, but is there not a requirement already, under previous local government finance legislation? You sound like you are saying that, in the absence of the Audit Commission website, there is no way to compel a local authority to reveal who its auditors are. That may be true, I do not know, but most of my constituents would be under the impression—rightly or wrongly—that who a local authority’s auditors are, whether through the Audit Commission directly or private sector auditors under contract, would automatically be public information already and anyway, before the Bill came along. Is that wrong?

Michael O’Higgins: It is public information because the Audit Commission publishes it.

Q11 Mr Bacon: Hang on. They are two separate statements: it is public information; and the Audit Commission publishes it. They may coincide, they may be the same thing. Are you saying that unless the Audit Commission published it, it would not be public information? If I phoned up South Norfolk council in the absence of the Audit Commission website, I could not find out who South Norfolk’s auditors were and it would be under no obligation to tell me. Is that what you are saying?

Marcine Waterman: Let me just—

Q12 Mr Bacon: Is that what you are saying?

Marcine Waterman: I am not saying that. I am actually saying that there is no obligation on a body to publish who their auditor is, but most do locally. What we are saying is that it is very difficult to find. It is not something that is right out there so you can say who the auditor is.

Michael O’Higgins: One reason why it is important is rotation of audit appointments, which has come up in other forums. If you want to know for how long a firm has been the auditor, it helps if you know who the auditor is and when they were appointed.

Q13 Ian Swales: It sounds like we now need a parallel to corporate law in public bodies law, doesn’t it? Corporate bodies have to publish who their auditors are as a matter of company law. Perhaps we are missing a trick and by moving from the old regime to the new we are not picking—am I getting the point?

Marcine Waterman: Yes, that is the point about individual bodies, but my point is about 855 bodies. It would be very difficult to ring up each council or look on each council or health body’s website to find out who their auditor is.

Michael O’Higgins: That is a matter for judgment by Government and the Committee—whether they think it desirable that that information is easily available centrally. The key point is that it should definitely be available locally.

Q14 Mr Bacon: Already? Sorry, can I just be clear about that? They are two separate things: whether it is available and whether someone is collecting it centrally. You are saying that it should be available publicly somewhere anyway? Yes?

Michael O’Higgins: And the Commission—

Mr Bacon: Yes? Sorry, nodding doesn’t register on the transcript.

Michael O’Higgins: Sorry, can I get the point across? The Commission in the evidence it submitted to DCLG when I was the Chairman made a number of points about analogies with the Companies Act and said that as far as possible the structure should be similar. This will be one of those analogies.

Q15 Mr Bacon: I still haven’t got the answer to my question. My question was irrespective of whether it is available centrally because the Audit Commission is pulling it together. I think you said—I just want to be clear about this because it is very interesting if it is not true—that it should anyway already be available publicly somewhere. It might be in not particularly well-defined positions so that it is always easy to find on a local authority’s website. Are you saying that it should already be publicly available somewhere?

Michael O’Higgins: I am not saying that. I am saying that for the future it should be.

Q16 Mr Bacon: Yes, but at the moment are you saying there is no obligation for a local council to make public who its auditors are? Is that what you are saying?

Michael O’Higgins: The question has not occurred to me before because obviously I would just look at the Commission’s website—

Q17 Mr Bacon: That is my question.

Chair: Let us see if Marcine can answer that.

Marcine Waterman: I think the answer is they do publish. There is no requirement to publish.

Q18 Chair: Why do we need the national list? Why do we need to know nationally who the auditors are for every local authority? I can see why you want to know and my residents in Barking and Dagenham want to know, but why do we need to know nationally?

Marcine Waterman: The first reason is ease of ensuring that every body does have an auditor, that each body has appointed an auditor, that their period of appointment is for the right amount of time and hasn’t lapsed, and the second is the need to ensure...
that people can contact or have a direct relationship with the auditor.

Q19 Chair: Why nationally?
Marcine Waterman: This is my point about the need to assure accounting officers that the audits have been undertaken and what were the outcomes of the audit.

Q20 Mr Bacon: And also, presumably, what percentage of the audit business is being done by any one firm. There are lots of reasons why you might want the information.
Marcine Waterman: Academics might like it as well—

Q21 Mr Bacon: It is surprising to me that you are saying categorically that at present there is no obligation on a local authority to publish who its auditors are. You are saying that, aren’t you?
Marcine Waterman: I believe that to be the case. Mr Bacon: Well if that is true it is very surprising. I am sure that the Department will correct us if that turns out not to be the case.

Q22 Meg Hillier: One of the interesting issues in this is how we guarantee the independence of audit. The Audit Commission has previously been able to provide that role. There are proposals in the Bill to have these independent audit panels and Marcine you commented on that in your submission. Do you think that the proposed regime guarantees the independence of public audit?
Marcine Waterman: It is a very good question, and it links directly with whether independent auditor panels will work and whether they can safeguard auditors’ independence. I think we all agree that robust audit arrangements in the audit process are a must. We think auditor independent panels are not workable or practicable. They are costly, and it would be very difficult to source independent members. We believe also that they are, in essence, ‘governance in limbo’. They cross over, they duplicate and they confuse the functions of local authorities’ own governance structures and audit committees. So it is not our preferred option.

Q23 Meg Hillier: Could you outline what your preferred option would be?
Marcine Waterman: Prescribed audit committees that comply with the relevant guidance, similar to what happens in central Government and the NHS.

Q24 Meg Hillier: One of the interesting things for those of us who have gone through local government is that you could say that councillors were there to hold the council to account, and they could be the people who appointed the audit committee. Do you think that would work? From what you have said, probably not.
Marcine Waterman: What is important is not who the person is; it is the skills and experience that they have. We do believe that the Bill could be strengthened by imposing a statutory duty on audit committee members to uphold the independence of the auditor. It is less important who the individual is, as long as they have the skills and experience to undertake that work.

Q25 Mr Bacon: And you are saying that prescribed audit committees, analogous to those for the NHS and central Government, would exist for each local authority. There would be, to take my example again, the south Norfolk council audit committee, which would be a prescribed body under statute and have members with certain obligations, including statutory obligations. The audit committee would have the job of appointing the auditor. Is that what you are suggesting?
Marcine Waterman: Given that the Government are against any sort of centralised commissioning body, which is the ultimate in providing independence, we think that it is practicable and workable to impose those additional statutory powers on the audit committees, yes.

Q26 Chair: Michael, do you agree with that? Do you wish to dissent from or develop that argument?
Michael O’Higgins: An additional point I would make, Chair, is that a potential reason not to have the councillors on the committee is that in a minority of cases in the past, financial irregularities have occurred. The Commission quite regularly comes under pressure from local authorities to change their auditor because they do not like the line of investigation that the auditor may be pursuing. A mechanism to ensure that there is an ability for the auditor to remain independent, and to be unpopular where necessary, is quite important.

Q27 Mr Betts: When we looked at this on the Select Committee, we came up with slightly different formats for appointment and removal. Removal, which you just alluded to, is crucial. We said that appointment was the responsibility of the whole council on the advice of the audit committee, where the audit committee would have a majority of independent members with an independent chair. We said that removal of the auditor could only be done with the agreement of the audit committee and the whole council. There was a double lock to make sure that there was absolute support for auditors taking unpleasant and difficult decisions. I would like your reaction to those ideas.
Marcine Waterman: On your first point—the full council making the appointment on the advice of the audit committee, with the audit committee made up of independent members—we recognise and we have heard that that would be difficult to achieve in terms of sourcing enough independent members across 855 bodies. We are looking for a more pragmatic solution to your suggestion, which we agree with—that the audit committee would make a recommendation to the full council.

Q28 Mr Betts: I was going to come back on the point about removal of auditors.
Chair: Yes, I want to talk about removal. Who is going to deal with that?
Marcine Waterman: I think the Bill sets out the proposal as you have stated it, which is that the audit
committee could make a recommendation for removal and that would have to be approved by the full council.

Q29 Mr Betts: The Select Committee was slightly tougher. We said that both the committee and the council had to agree; it was not just a recommendation for removal. We thought that was the absolutely key issue of independence.

Marcine Waterman: I agree.

Michael O'Higgins: A double lock makes sense to me, and the advantage is that it would give councillors the opportunity to ask the auditors to explain why they believe they are being removed.

Q30 Chair: How often, in your period in the Audit Commission, did you have occurrences of local authority councillors trying to get rid of their auditors because they did not like what they were saying?

Michael O'Higgins: It is not always the councillors; it could sometimes be directors of finance, because they are the ones who are closer to the petard if things get hoist. There are two types of incidents I can give you. One is when there is pressure to change an auditor. Another is where there is a suggestion that fees will not be paid because they do not like what the auditor is doing. One of the strengths of the commission in its existence thus far has been its ability to say to auditors, “We will continue to pay your fees while this dispute goes on, because we will stand behind you.” Similarly, in the case of one very large local authority that had a disagreement with its auditor—one of the major firms—and wanted it changed, we refused to change it until the issue had been resolved.

Q31 Chair: How often does that happen?

Michael O'Higgins: Certainly once or twice a year there will be pressure, either very explicit—sometimes—or, more often, rumbles.

Q32 Chair: I am just not sure that the new system of double lock will stop it.

Michael O'Higgins: It might not, and that is one of—

Q33 Heather Wheeler: You just said that fees sometimes were not paid because councillors did not like what the auditor was doing. A perfectly reasonable opportunity to have a dispute with the accountants is if they are running up massive fees for no good reason. I think that you ought to put it on the record that it is not just that councillors might not like what the auditor is doing; it might be that they do not like their time wasting. I am certainly aware of accountants reducing fees from £70,000 to £40,000 quite amicably, but if you had stood behind them that would not have happened.

Michael O'Higgins: It depends on the reason why there is a dispute. Clearly, that will happen, but—

Q34 Heather Wheeler: I think it needs clarification—there are two sides to it.

Michael O'Higgins: Right. There are other times when there is a dispute because the councillors do not like what the auditor is doing because it is painful. To finish off the example I was giving, the large authority wanted its auditor changed, but the Commission refused to do so until the issue had been resolved. At the end of that, we changed the auditor because there had been a breakdown of trust, but in order that the firm involved did not suffer as a result of pursuing its integrity, we gave it another very large, similar-sized account instead. So we ensured that there was no commercial loss to the firm from doing the right thing.

Q35 Mr Bacon: I would like to pursue this because it relates directly to the issue of public interest reports. Under the draft Bill, there is an obligation on auditors to issue public interest reports, after advising the audit panel, in circumstances in which they consider that there has been serious financial mismanagement or underperformance. Under the new structures proposed by the Bill, do you think that auditors would feel inhibited in issuing public interest reports on the basis that they might lose business—they might lose business or not get awarded in the first place if they got a reputation for issuing such reports?

Michael O'Higgins: I am on the record as saying that no public interest report has been issued on a foundation trust since they got the ability to appoint their own auditors. That may be coincidence, but it is not as if the NHS has been a paragon of virtue in the past seven years, and some of the troubled institutions have been foundation trusts. It is not that someone would sit down and say to themselves or to the team, “Look, we are in danger of losing an audit if we pursue this”; the process is more subtle than that—understanding that the tender is coming up and feeling that your relationship is going to break down if you pursue the matter and it is then, maybe, a question of having your judgment shifted several degrees to one side.

Q36 Mr Bacon: Is that not the point, that all these audit questions are questions of whether it is, first, de minimis or not—not a complete black and white issue, but one that has to be looked at in context—and then questions of judgment are always involved. What you are really talking about is not instant corruption but a series of nuances that move you slowly in one direction rather than another. Yes?

Michael O'Higgins: Cultures of corruption or misappropriation rarely begin with one big step. They usually occur as a result of a series of small culture changes that are a little insidious but do have an impact over time.

Q37 Chair: How would you counter that? I think we completely understand the point that is being made, which has been made by most people who have given written evidence to the Department and to ourselves, but how would you counter that on the face of the Bill or in regulations so that you maintain the integrity and the power of the public interest report?

Marcine Waterman: There are a couple of examples. One of our recommendations is where the Bill talks about the auditor seeking advice from the auditor panel—that could actually fetter the discretion of the auditor. The auditor should be able to pursue an investigation that results in a public interest report,
regardless of whether the auditor panel or the audit committee agrees. Secondly, we believe that there should be a mechanism in the draft Bill that guarantees—or a mechanism to recover—reasonable costs associated with pursuing an investigation.

**Q38 Chair:** That is a thing of interest. As we were discussing just before you came in, Westminster was the great example, which probably ran into millions, but the Audit Commission stood behind I cannot remember which company—

_Michael O’Higgins:_ Touche Ross.

Chair: Touche Ross did it—they only went ahead with pursuing the public interest route because they knew their fees were covered. I just don’t see how that is going to work in the new environment. Again, because we are looking at the draft legislation, can we ask what you would place in the draft legislation to ensure that you could have that, we hope very infrequent, public interest audit of the report, as we had in Westminster.

_Marcine Waterman:_ That is why I suggested in our response that you should have a statutory mechanism for the auditor to recover the costs.

**Q39 Chair:** From whom?

_Marcine Waterman:_ From the local authority.

**Q40 Chair:** But if that is £2 million, in today’s money that would be a fortune.

_Marcine Waterman:_ If there is a dispute about costs, there needs to be a third body to help mediate the dispute. It could be one of the bodies that will have a role in the new regulatory framework set out in the Bill.

**Q41 Chair:** Who?

_Marcine Waterman:_ The FRC or the NAO, but you need to protect the auditors’ independence in order for them to be able to issue such a public interest report.

**Q42 Ian Swales:** On the issue of public interest, one key element—if we think about some of the scandals over the past few years—is how we deal with whistleblowers. Whether it is my local police force, or my constituent who blew the whistle in an academy, it is often that route by which these things are uncovered, rather than audit. How do you think we can strengthen that channel in the Bill? Is what is in the Bill adequate? How do we protect whistleblowers, and how can they get in touch with their auditors?

_Marcine Waterman:_ That is quite interesting, because actually the Bill makes no mention of whistleblowing at all, and we think that is one area that needs to be strengthened. You are absolutely correct—both the Audit Commission and its auditors are prescribed people under the whistleblowing legislation. Right now, that is not included in the Bill, and it needs to be. We need to be able to ensure that people can raise issues. You are absolutely correct. Just think about Wirral council—that issue came from a whistleblower, not direct from an auditor’s investigation.

**Q43 Ian Swales:** Can you just tell us briefly how it works now, and what you think needs putting in the Bill in the new regime around whistleblowers?

_Marcine Waterman:_ Currently, in the Public Interest Disclosure Act, both the Audit Commission and its relevant auditors are prescribed persons. The Audit Commission has a direct public interest disclosure telephone line, and we then alert the relevant auditors, or the auditor is called directly. Going forward in the future, the appointed auditor should be the relevant prescribed person, but you do need to consider whether another body has the relationship that we do, and will be able to pass information to an auditor. The Bill does not currently allow anybody to have any type of direct relationship with auditors.

**Q44 Ian Swales:** Say a bit more about what you mean by prescribed. I presume you are saying “prescribed”, not “proscribed”.

_Marcine Waterman:_ Sorry. It is my accent. It is “prescribed”.

**Q45 Ian Swales:** No, it is okay. Just say a bit more about what you think we would need to do in the new regime. Clearly, if I work in my local council and I want to blow the whistle, then if we get the other parts right, I will know who my auditors are so I can contact them. What needs to happen? What protections do I need, and what needs doing in order to make sure that channel is as open as it should be?

_Marcine Waterman:_ As long as the Bill directs the whistleblowing powers to the auditor, you have that element covered. If you have strengthened the element that allows someone to find out who the auditor is, that should be fine. The issue, I suppose, is that you cannot always get hold of your auditor. Who else, in this new framework, could be available to help pass on that information?

**Q46 Ian Swales:** Do we need to tighten up how the auditor behaves with such information? Does that need to be in the Bill? In other words, things like anonymity and so on. Do we need to say that?

_Marcine Waterman:_ That is covered already by the framework around auditors.

**Q47 Chair:** Which is the other body you would look at in this instance?

_Marcine Waterman:_ Obviously I haven’t spoken to anybody about who would like to take that on, but it needs to be somebody who has been assigned some of the regulatory functions, so either the RSBs, the ICAEW-type people, the FRC or the NAO. Somebody in the framework needs to have another role that can actually pass on additional information.

_Michael O’Higgins:_ The sort of instance where a single local authority might not be enough is, for example, if there is a combined purchasing agreement between several local authorities and somebody believes that there is some corruption somewhere. They may not know which of the local authorities to go to, but if they put it to a central body, that can be checked out using the powers of the central body.
Q48 Ian Swales: Is that where we could use the management of the Department to be that? I am concerned, listening to this discussion, that every time we turn around we build another body in, and we will end up with an incredible superstructure. At the end of the day, the Department for Communities and Local Government, in this case, has massive management responsibility for what is going on.

Michael O’Higgins: I can perhaps now say that in my experience, the management of the Department for Communities and Local Government has quite enough challenges to be getting on with.

Marcine Waterman: I would add that one of the results of this draft Bill, obviously, is the fragmentation of the audit regime. I appreciate that the Government’s policy decision is not centralisation, but rather than one body managing this process, you are introducing six to have a role. There is going to be fragmentation, and of course that will increase costs.

Q49 Meg Hillier: There is centralisation, peppered through the draft Bill. Powers are passed to the Secretary of State. I am not sure on this point, but I think the Secretary of State could probably do what he wanted. He could do what you are suggesting.

Marcine Waterman: Yes.

Q50 Chair: The interesting thing, thinking about it, is that you would have thought that whistleblowing would go to members of the local council.

Marcine Waterman: I am not as familiar with the whistleblowing legislation and what their powers are, but we could find out and provide information to you.

Michael O’Higgins: It depends on the nature of the concerns that the whistleblower has.

Q51 Ian Swales: It depends on the council as well.

Chair: It depends a little bit on the council, but I am thinking of the way we work on the Public Accounts Committee. We are inundated with whistleblowing. It is sort of an analogous situation, is it not?

Ian Swales: From the evidence that we are hearing, it is vital that the auditors have a key role. We all know of cases—I can think of some hardly a few miles from my constituency—in which people who are apparently independent of the executive of an organisation are not really, and that is where the trouble started. The very times when you need to blow the whistle are often the times when that part is not working.

Q52 Heather Wheeler: Carrying on from that but moving slightly away from it, we are really interested in the amount of detailed work and the robustness of the benchmarking. Where should it sit now, this business of benchmarking across local authorities? We have heard that instead of 16 reviews, there will probably be only six. Will it be strong enough? Where will it all be pulled together?

Marcine Waterman: I think what you are asking is how the commission uses the information we collect to produce national studies. We have two very important tools. One is called the value for money profile, which benchmarks all local authorities on important indicators of both cost and quality. We use that information to inform some of the national studies that we do; we have one coming out on foster care. This tool is valuable and we would not want it to be lost, but it is also a fundamental tool for auditors in reaching their value for money conclusion, because it provides them with factual evidence as to how the bodies are putting in arrangements to achieve economy, efficiency and effectiveness. It is a fundamental tool in our regime.

The proposed Bill talks about the NAO picking up and producing the code, which would include what the auditor would do under the value for money conclusion. Our view is that that tool is quite important to that process if everybody agrees, as we have heard, that the tool is of value. The commission is also able to collect quite a lot of information directly from auditors about their audit work, either around financial ratios or on financial resilience in the current economic conditions. Because we have that direct relationship with auditors, we can survey auditors at no additional cost, because we specify what they do. They produce that information for us, and that is what our reports are based on. We have that direct relationship with the auditors. Again, that will be lost in the proposed arrangements, because there is no mechanism for the NAO to have a direct relationship with the auditors to collect that information. Indeed, if they have the power to collect that information, how will they pay for it?

Q53 Heather Wheeler: Would that then be quite a cute way of reversing it back, by saying that, for every single audit of every single council, health authority or whatever it is, a copy is just sent to the NAO? The NAO can then do what they want with it, and pick the bones out of it anyway. If the NAO want to publish them, they can publish them.

Marcine Waterman: Auditors’ reports are based on the auditors’ code of practice and what they need to report. Some of the information that we collect is actually in addition. For instance, on financial resilience, whether they think that the audited bodies are coping with the cuts and how resilient they are going forward are not things that auditors are putting in their public reports, because they can stand behind us and the commission can give the central message about how many councils are struggling rather than individually naming them.

Q54 Ian Swales: That is a very important point. To what extent do we expect the new regime to look at financial information and to what extent do we expect it to look at the management information? If you get in an auditor of a corporate body, they are essentially looking at financial information. You have to ask them to do management information studies or data or whatever, and I am not sure we are clear on that.

Q55 Chair: Building on that, what I am unclear about—and we have great concerns about this on the Public Accounts Committee—is whether the framework that the NAO will devise, which auditors will be obliged to adhere to, will be sufficiently robust and detailed to enable us to pull out of the NAO and then through to ourselves all of that rich data that you
currently collect, which allows you to do resilience, and VFM, and all these things.

**Michael O’Higgins:** It is a question of what power the NAO is given to request information from auditors and whether they inherit our powers to ask for that information.

**Q56 Chair:** Do they, on the face of the Bill?

**Michael O’Higgins:** No. So that might be something to look at, if you take the view that there may be occasions when the management information will be important as well as the financial information. If I go back again in my time to when we did the report called “Tough Times”, which was the first report looking at how local authorities are coping, central Government asked us to come in and give evidence to the National Economic Council about this. We were able to get that information very rapidly by asking each of the auditors to do a quick return that we devised. It may be that you take the view that that power is not necessary or that you think that it would only be used very infrequently, but I think it is worth considering whether or not having a power like that available to the NAO would be helpful.

**Q57 Mr Betts:** Could I make an additional point? The Secretary of State still has a fall-back power to intervene with an authority that is seen to be failing. Is the sort of information you collect not merely helpful when looking at the overall picture, but in spotting particular authorities as well—those that are in difficulties, maybe, in managing particular situations?

**Michael O’Higgins:** Absolutely. For example, when we were doing “Tough Times” and “Tough Times 2”, we were looking at authorities. We did not know whether a particular authority might be having problems that were sui generis or were just problems that were shared by other authorities. For example, with district councils it became clear that income from parking charges and from planning permission requests had gone down sharply. You could look across authorities to see which were most heavily hit, which had become most dependent on this.

**Q58 Mr Betts:** In the end, that collected information could form the basis for the Secretary of State saying, “Actually, there is something going wrong here. We have got to look at this authority in particular.”

**Michael O’Higgins:** It is an example of where the auditing process can collect information in advance of failure rather than simply dig up and pronounce on the causes of failure afterwards.

**Q59 Mark Pawsey:** So would you say that in the absence of this work there could potentially be more problems within local authorities or that a problem could persist for a longer period than would otherwise be the case?

**Michael O’Higgins:** The Local Government Association or other body might want to have some mechanism to enable a chief executive or director of finance to know whether their position was more extreme than the norm. At the moment we can provide that information. It is not clear where that would come from in the future.

**Marcine Waterman:** We currently support the Local Government Association’s peer review process by that valuable tool, in giving information across the piece. It is not just about one indicator. When you start to see indicators building up across a range of financial and service indicators, then that starts to tell a story.

**Q60 Chair:** We think this is very important. So, to toughen it up, you would want, on the face of the Bill, a specific power for the NAO to require auditors to provide certain data to the NAO?

**Marcine Waterman:** Yes, but with that you would have to think about how the auditors would be remunerated for that work and how the NAO can actually pay an audit firm to collect that information. Obviously currently that is a top slice from the commission, on our fees.

**Q61 Mark Pawsey:** At the same time as you are doing that work you identify issues that can go to the National Fraud Initiative. How will they be alerted in future?

**Marcine Waterman:** The National Fraud Initiative is widely seen and recognised as really adding value in identifying fraud and error. Indeed, we have now identified nearly £1 billion in fraud and error across all of our participants. We are glad to see that the Government want the NFI to continue and to find it a home. Regardless of where its home is though, that connection with the local auditor again will be lost. It is the auditor that chases and pushes the public body to pursue the recommended matches. There is nothing currently in the plans that would allow that relationship to continue.

**Q62 Mark Pawsey:** Where would you see that work placed?

**Marcine Waterman:** The Government have identified three homes for the NFI: DWP—

**Q63 Mark Pawsey:** Sure, and which is your preference?

**Marcine Waterman:** Our preference currently from the ones that have been announced would be the Cabinet Office in meeting most of the requirements. But we are aware that respondents to CLG have recommended the NAO.

**Q64 Mr Bacon:** The NAO?

**Marcine Waterman:** Yes.

**Q65 Mr Bacon:** Wasn’t the Home Office one of the suggested homes?

**Marcine Waterman:** The National Fraud Authority, which is in within the Home Office.

**Q66 Mr Bacon:** So there are four suggested homes are there?

**Marcine Waterman:** The Government has suggested three.

**Q67 Mr Bacon:** Which are?
Marcine Waterman: DWP, the National Fraud Authority and the Cabinet Office. In response to the Government’s consultation on the Bill some respondents said the NAO would be a good fourth option. Again you might have that relationship with auditors and if you remember the code, if the NAO continues with the wide scope of audit, which includes auditors’ responsibilities around probity and governance, there might be a good link to having them look at the fraud agenda.

Q68 Mr Bacon: Your preference is the Cabinet Office?
Marcine Waterman: Of the three that are currently proposed. If the NAO were to come in as a possible home I think we would like to have a discussion about how they could take this forward. What is important is that we maintain the NFI and continue to develop it so it can address future operational and financial risks.

Q69 Mark Pawsey: Do you think the way we are moving gives enough power? Would things get spotted as quickly as under the existing regime or is there a danger that more fraud and loss could occur under the new regime?
Marcine Waterman: Well if the NFI is not found a suitable home where it can develop and continue and have that relationship to push to have the matches addressed, then it could unravel and you could start to lose the benefits of having the initiative.

Q70 Mark Pawsey: So with a suitable home you could carry on as before?
Michael O’Higgins: It is not just a suitable home. It is slightly more than that. What the National Fraud Initiative does is identify transactions that may be suspicious. They are then passed to the relevant body for investigation. The advantage of the current arrangement is that the auditor can pursue with the relevant body whether they have investigated those potentially suspicious transactions. So there would need to be a nexus not just to identify potentially suspicious transactions but to have somebody with responsibility for following up on them.

Q71 Ian Swales: We are mainly spending our time addressing the Bill for the new state but also, clearly, we have concerns about the control regime in moving from the old state to the new state. What does the Bill say about transition? Is there more we need to be doing on that front?
Marcine Waterman: It says very little about transition and that is one of our biggest concerns about gaps in the Bill. There are two transitions. There is a transition from the current Audit Commission, when we are abolished in March 2015, until when the audit contracts that we have recently let expire in 2017. So there needs to be a residuary body to oversee those contracts and ensure high-quality delivery of audits. So there is a two-year period where again if a home has not been found—

Q72 Chair: Has the issue been identified by the Department?
Marcine Waterman: They have identified the issue.

Michael O’Higgins: I would rephrase that. I think the issue has been identified for them.
Ian Swales: It is a shame you cannot capture body language on the transcript. The issue has been identified. Very good.

Q73 Mr Bacon: As George Orwell said, never use the passive when you can use the active. Is one potential answer that those powers in some residuary body would just rest directly with the Secretary of State and the Department?
Marcine Waterman: Yes, the Secretary of State could have the residuary body, if he would like to oversee the contracts and ensure the delivery of the audits.
Chair: The Secretary of State does not run much in DCLG.

Q74 Mr Bacon: So it would be possible to set up a contract supervision unit in the Department? I am not recommending it, but that would be one possible solution.
Marcine Waterman: You would have to have staff who understand it.
Mr Bacon: Well, that has never stopped them in the past.

Q75 Meg Hillier: Presumably, if you are going down that route, for expertise reasons you would expect some of your staff to be TUPE-ed over? So you would be adding to the payroll.
Marcine Waterman: Absolutely, because, if you remember, these contracts were set up, agreed and signed under the auspices of the Audit Commission Act, so our code continues, our providing auditors with guidance continues and our regulation of the auditors continues. All of that needs to continue in order to ensure that the prices are not changed from what we agreed.
Michael O’Higgins: I would add one further complication, which is that the contracts that we signed provide for five-year contracts, with the possibility of extensions of up to eight years at the same prices—fixed in current price terms.

Q76 Mr Bacon: Is that an additional eight years, or is it that after five years you can get an extra three?
Michael O’Higgins: It is a possible eight—an addition of up to three years, at the discretion of the commission, or whatever the successor body is. So the period over which the transition will continue could conceivably extend as far as 2020. Commercially, it would be very attractive for whoever takes over from us to extend those contracts, because you are not going to get those prices again.

Q77 Meg Hillier: There is a practical issue here. I imagine you may be losing staff already because of what is coming—is that a fair assumption?
Marcine Waterman: We have reduced the size of the Audit Commission in line with the policy decisions to stop CAA inspection, so we are now downsizing to an organisation of only 66 in size, which is needed to fulfil our statutory powers for these contracts.
Q78 Meg Hillier: But in all honesty, there will be temptations for a lot of the staff you have, as human beings, because there will be a lot of opportunities coming up in the private sector, and, with the expertise that your organisation has, those companies will be very keen to offer jobs to Audit Commission staff.

Marcine Waterman: These people are not auditors, these are policy people who oversee audit regimes, so whether they go to a firm—

Q79 Meg Hillier: What I am driving at is which is more attractive, going to a firm or possibly being taken in by DCLG? The danger is that the very people who understand the regime might be poached by the private sector and not be available to DCLG, so then the benefit of any residuary body being within DCLG would be diminished.

Marcine Waterman: That would be a very real risk. There is already a risk, which we must manage in order to maintain these 66 people until we are abolished. So yes, indeed, it is a very severe risk.

Q80 Chair: So on the transitional arrangements, they need to sort out who is running the audit. What else is there?

Marcine Waterman: Then you have the second transition. As Michael said, you need to decide whether it comes in 2017 or you lock in the prices and it comes in 2020. Obviously, there is a critical policy decision about retaining the lower audit fees and the cost of the whole regime until 2020, or whether it is more important to introduce local appointment. That is a balancing act. The next regime transition would be from the commission’s regime in 2017 or 2020 to the introduction of this new framework. One of the issues with having two transitions, obviously, is that you are going to be running two regimes, and I think that that can add to confusion as well as costs.

Q81 Mr Betts: Whose choice would it be to extend the contracts in 2017?

Michael O’Higgins: The successor body to the Audit Commission.

Q82 Mr Betts: So the local authorities themselves would have no say about that?

Michael O’Higgins: Unless they were consulted about it. They were consulted about the current contract, because, as you may know, we asked for three-year and five-year bids to see what the price difference would be. The bids came in, and there was not much difference between three and five years—I think it was about 1.5% per year over the duration of the contract—but the prices were so low, and they were fixed current price rates, so it was a commercial no-brainer to go for five years. When it was put to the Local Government Association—I took the view that it needed to be consulted—it decided that it needed to discuss this with the Secretary of State, who acceded to the request for five-year contracts.

Q83 Mr Bacon: What about the accounting officer?

Presumably, in 2017, he or she would have a role with whatever the subsidiary body was, testing whether the move away from the existing contract and its potential extension for three years to an eight-year contract, which would be stupendous value for money, could be justified. He might well turn around and say, “This cannot be justified on value-for-money grounds. The best thing to do is to stick with what you’ve got, and if you want to move away from it you had better issue me with a letter of direction because I cannot justify it.” The accounting officer could easily do that, couldn’t he?

Michael O’Higgins: Yes, I believe so.

Mr Bacon: If the gap is sufficient.

Michael O’Higgins: What the mood will be in 2017 or 2015, when a Secretary of State in the next Government—whoever that may be—makes a decision about this, is hard to call at this time. When we discussed with local government about three or five-year contracts, in the balance between wanting local freedom to appoint an auditor sooner versus getting really good prices locked in for a long time, people came down on the side of the latter.

Q84 Mr Betts: We have had a lot of figures about the actual or potential savings from the abolition of the commission. I think the latest ones are that the Department has said that it will save £1 billion over 10 years and £650 million over the next five. The commission is now saying that there will be savings of £1.7 million a year, so there is rather a big gap in expectations. Could you just explain simply and clearly what your understanding is of the savings figure you have come up with and why it is so different from the Government’s?

Marcine Waterman: I am pleased that you asked that, and I am pleased that we can clear this up. We are not disputing their numbers, and obviously we did not calculate them. We all agree there are savings, but our difference is that 99% of the £650 million has been banked already. All that is left from abolishing the commission is a mere £1.5 million. That is using DCLG’s own figures in their impact assessment. They have assumed that the cost of moving some of the aspects of our regime to the NAO and to the Financial Reporting Council is £5.8 million. If the Audit Commission costs £7.5 million, all you are saving from abolishing the commission is £1.7 million, and I am already bringing those costs down since I have been appointed.

You have got to remember that as soon as the prices are let loose in the market those savings will be eroded anyway, because we truly believe that audit fees will increase. Then there is the cost to the audited bodies themselves of having to run an EU-compliant procurement every five years. Just using the numbers that the LGA provided to us, we have costed that to be £19 million. Boom! There goes your £1.7 million. We are not disputing the £650 million. It has been banked. It has been saved by the Government’s policy decision to shut us down—

Q85 Mr Betts: Just explain to us what that saving is.

Marcine Waterman: That saving has been achieved from the Government asking us to stop inspection and comprehensive area assessment, and from outsourcing
the audit practice. That is how those savings have been achieved.

Q86 Mr Bacon: How much is one and how much is the other?

Q87 Chair: Yes. How much did you save from outsourcing?

Marcine Waterman: We have given back £50 million with a 40% reduction in audit fees. We have reduced fees by 40%.

Q88 Mr Bacon: We are talking about £650 million. You are saying that it has been banked already and that there are two sources. One is the scrapping of comprehensive performance assessments and the other was—sorry, could you repeat it?

Marcine Waterman: Outsourcing of the audit practice.

Q89 Mr Bacon: Right. How much of the £650 million was due to the scrapping of the comprehensive performance assessments, and how much of it was due to the outsourcing of the audit?

Marcine Waterman: I do not have those precise splits, but I am more than happy to provide the Committee with those numbers if you would find that useful. We will write to you.

Michael O'Higgins: They are cumulative numbers. We tend to look at the annual saving, so we would need to look at the exact time period over which it was done.

Mr Betts: It would be very helpful to have a comprehensive but clear and simple statement of those.

Q90 Mr Bacon: Very roughly—by all means, please do write to us—proportionately, without signing your name in blood, how much is roughly one and how much is roughly the other?

Marcine Waterman: I really would not like to say, but I assume because the £650 million has a lot of compliance cost from the audited bodies having to comply with CAA, which I think they estimated—Chair: Comply with what?

Marcine Waterman: Comply with comprehensive area assessment. So I believe that the majority would come from the policy decision to stop inspection in CAA.

Q91 Chair: Let me get this clear; it is an annual saving of £130 million. The £650 million is a five-year saving.

Marcine Waterman: That is correct.

Q92 Chair: So it is an annual saving of £130 million, of which probably half goes to comprehensive assessment, and the other half to outsourcing.

Marcine Waterman: Which stopped two years ago. That is our point about the savings having been banked.

Q93 Mr Bacon: So they should have banked £260 million already, of which a significant proportion is due to the assessments.

Michael O'Higgins: We stopped the work on comprehensive area assessment the day that the Secretary of State announced that he was minded to stop it. We did not wait to receive the letter from him.

Q94 Mark Pawsey: Can I ask you to confirm your assertion that audit fees will go up and that you are getting a very good deal now? How can you evidence that? What is your assessment of by how much audit fees will go up, and why?

Michael O'Higgins: I am happy to take part of that. I have a professional services background as well. We were able to look at the savings from the outsourcing exercise that was recently completed when I was still chair by comparing the prices offered then to the prices offered for the 30% of the market that had previously been outsourced. We had an existing 30% outsourced to professional firms, so we could see by how much further they were taking the prices down with the new prices. It was clear that there were a couple of firms that chose not to go for low pricing. They made a different commercial decision and held their prices at the previous rates and won no contracts as a consequence. The others went down significantly. Why did that happen? First, they were very large contracts. It was £100 million of work a year. Secondly, the economic climate meant that that £100 million was even more attractive than normal. Thirdly, firms wanted to be in the market before it liberalised, because they would have no credibility if and when it did liberalise. In my judgment, the likelihood is that, should liberalisation happen, very large or attractive authorities—the Birminhams and the Westminster—may well be able to get quite good deals, but there will be many smaller and more remote authorities that will not benefit from the sort of Post Office pricing that the Commission carries out.

Q95 Mark Pawsey: So you got the prices down by being cleverer on your procurement and doing that better. Why are we not able to keep that clever procurement going forward?

Marcine Waterman: Because we did not achieve these just from bulk procurement. It is because we have the powers of being able to appoint and ultimately impose the auditors. That is how you achieve those savings.

Q96 Mark Pawsey: Sure, but why can those savings not be maintained going forward?

Michael O'Higgins: If you look at an individual authority tendering on its own, it is going to have the costs of doing that and it may not have the expertise to do that in the same way. It is also not going to be particularly attractive for a major audit firm to bid for one authority, so they will be pricing quite differently depending on the type of authority unless there is some mechanism for bulk procurement.

Q97 Mr Bacon: Given the pressure that local authorities are under to share services, whether they are legal, financial or HR—Kensington and Chelsea, Westminster, and Hammersmith and Fulham all have the same chief executive—do you think that there will be an inevitable pressure on local authorities, to
which, for all I know, some are responding already, to do joint procurement of auditors in a larger framework to achieve more or less the same result.

Marcine Waterman: Joint procurement can work, but two issues need to correspond. One is that you must be willing to audit all of the bodies in the joint procurement. Second is that you have to be able to. There can be no conflicts of interest. Some of these very good-priced audits are where the firms are actually selling quite a lot of non-audit services, which would preclude them from being able to bid. They will make very big commercial decisions about joint procurements, and they will already be having conversations such as, “We’ll give you a good price if you don’t include these others,” because they will be looking at having to recover five-to-eight years’ worth of pent-up inflationary pressures as we have locked in the prices. They will have to be factoring in these additional regulatory costs that are coming their way, and they have to bid multiple times, whereas for us they have only had to bid once. All those factors together pretty much ensure that you are going to see increased prices.

Michael O’Higgins: Can I give an example of joint procurement? If you take, for example, the 10 local authorities in the Greater Manchester area, they work together quite a lot. You might ask why they cannot do joint procurement, but the chances are that any of the firms that might bid will be doing other work in at least one of the 10 authorities and therefore may be conflicted. By doing national procurement, they do not bid to audit particular authorities; they bid for blocks of work, and the Commission then allocates them to authorities so that they get the quantum of work that they bid for.

Q98 Mr Bacon: They have no say in advance as to where they will end up putting their auditors on a train to.

Marcine Waterman: That is correct.

Michael O’Higgins: And the Commission has always followed the apples and lemons policy. If you want to get some of the juicy apples or plums, you have to take some of the lemons as well.

Chair: You have given us very clear and full evidence, for which we are grateful. We have come to the end of the sitting.

Q99 Mr Betts: I have one quick point. What you are effectively saying to us is that you could carry on with the body as it is now and achieve the savings that you have achieved and do the job without any need for the draft legislation. Is that what you are really saying to us?

Marcine Waterman: Yes, if that was politically acceptable, that is correct. We could maintain the 66 people organisation at a very small cost and carry on.

Q100 Mr Bacon: You might have to change your name.

Marcine Waterman: We understand that. We are happy to have a new name.

Mr Bacon: Do you have any ideas? Perhaps we could suggest one or two.

Q101 Chair: I hope that we have covered most of the issues, but are there any issues that you wanted to bring to our attention relating to the draft legislation that we have failed to ask you about?

Marcine Waterman: I just think it is important that, throughout your scrutiny of the Bill, somebody addresses what is the position with regard to health bodies.

Chair: We are having a session on that. We are great experts here. The PAC members know it inside out.

Michael O’Higgins: Can I add one thing, wearing one of my other hats? The Commission has argued that pension funds should be treated as separate entities for auditing purposes, rather than as part of the authorities to which they are potentially connected, and this is consistent with the regulatory changes that have been put through in the Public Service Pensions Bill. I would ask that you have a look at the issue and, on the face of the Bill, have the pension fund be designated as separate entities.

Chair: Right. That is a good point. Thank you very much, that was really helpful.
Examination of Witnesses

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

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

I am going to start with a general question. David Walker: Before you do, the figure that you are after is in the annex to the Bill.

Q103 Chair: Which figure? David Walker: The figure for the cost of abolishing CAA, which was given by the Government as £28 million in the baseline year of 2009–10. That is the cost to the commission. The cost of compliance with the inspection regime—and it sounds plausible—is £218 million over 10 years at NPV, gets you near to the figure—

Q104 Chair: Thank you. David Walker: The figures are there and you can argue about whether compliance costs are as much as that, but there is a real figure in the Bill.

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

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

Q106 Mr Bacon: Can you just remind us: the double lock being the audit committee and the full council? Professor David Heald: The auditor panel strips me as a crazy idea. I cannot see where the independent expertise for so many authorities is going to come from.

Q107 Mr Bacon: I am asking a question about the double lock, not about the panel. Professor David Heald: Yes; so given the fact that I think the auditor panel has got to go, I think the right place to put it is in the audit committee, making a proposal that is accepted by the full council. I do not regard it as satisfactory, because of my principled objection to public bodies appointing their own auditors. If the Bill is going to go through in broadly its present form, I think the double lock is actually the best. The audit committee proposes and the council accepts, and I think the same kind of arrangement would have to happen about removal of auditors.

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

Professor David Heald: I do not know of any academic work on that. It takes quite a lot of time, because the statistical techniques need a number of years to establish that. I do not know of anything that has actually been done yet. David Walker: Hearsay says Monitor is sitting on 25, 30 or 40 foundation trusts that are in imminent financial difficulties. If, in the period preceding the announcement of their difficulties—we have seen announcements in south-east London—the auditors have been silent, that must say something critical about the audit regime, surely.

Q109 Meg Hillier: I wanted to ask Robert Black what the situation is in Scotland, in terms of maintaining independence, because I think that might be a useful comparator. Robert Black: I am very happy to do that. If I may, I will just give you a quick thumbnail, and then perhaps comment on this very important issue about the appointment of auditors.

In Scotland there is a single audit agency, Audit Scotland, of which I was the head until this summer.
May I just put in the record that I am speaking in a personal capacity now, but I am sure nothing I say will be at variance with what my erstwhile colleagues consider appropriate? There is a single public audit agency, called Audit Scotland, which in a sense captures a large number of the properties of the National Audit Office, and some of the properties of the Audit Commission. That gives the advantage of the single point of contact. We can do very good analysis of delivery chains, cross-cutting studies, and so on. We do not have any institutional or organisational barriers to that. The audit process is managed through Audit Scotland on my behalf, so rather like the Audit Commission used to operate, there is a tendering of the audits every five years. If you take public bodies in Scotland—something over 200 of them—they each have an appointed auditor, who is either someone supported by a team from Audit Scotland, rather like the old district audit service, or is someone from a firm. We employ the same large firms as feature in England. On the specific point about the advantages of independent audit, what I would say in Scotland is that I would be confident that the Scottish Parliament would be very concerned if there were a suggestion that each and every local authority or health body appointed their own auditors, because what they see in Scotland is that the audit reports are coming to them through the Auditor General or through the Accounts Commission. So when I was reporting to the Scottish Parliament—I must use the past tense for this—I could dwell on the content of all the audit reports for the umpteen health authorities, and so on. There is a body called the Accounts Commission, which oversees the local government; we work in the same partnership. So the strategic insight provided on the performance of the health service and the finances of the health service is found in the local audit reports. The final point I would make on that is there is a sense in which he who pays the piper calls the tune. So the audits are conducted according to a code of audit practice, and all the established standards at UK and international level. There is no question about that, but you can influence the shape of the audit according to the issues of concern either to me or to the Scottish Parliament. So you get that degree of control as well as giving a public reassurance about the fact that the auditors are not in any sense beholden to the bodies that appointed them. Finally, when it comes to the public interest reports, what invariably happened in Scotland is that issues would arise in a local authority, there would be a fairly good professional conversation between senior colleagues in Audit Scotland and the appointed auditor. Then Audit Scotland would come in behind the auditor and support them, and ultimately make the reports to Parliament or to the Accounts Commission. In a sense, it limits the risk and exposure of the firms, because the tough stuff is taken by Audit Scotland to take it into the democratic arena.

**Q110 Chair:** Going back to my original question, that has been a helpful exchange of risks and gaps, but is there anything else you think we need to build on? **Jessica Crowe:** We start from perhaps a slightly different point from some of those already made. To add something new is that we would say that it is important for audit to be seen as part of a wider culture of accountability in local public bodies. For us, one of the big gaps and problems with the Bill is the increasing fragmentation and gaps in accountability. It is a missed opportunity, as lots of public bodies are increasingly working together and there is a prospect some day of community budgets becoming quite significant, more pooled budgets and more joint budgets. The fact that health is missing has been referred to, but more widely it is a missed opportunity to do something about looking more sensibly at how public bodies spend their money in the round, and how they account to local populations. For us, there is a bit that is not in the Bill and is not talked about unless something follows on. We would say that the important thing is the simplicity and the way in which accounts and audits are presented to the public. If the Government are serious about transparency being an aim, all this process about who is the auditor and who appoints them, is not going to make it any simpler for any resident to understand how their council or anybody else spends their money, because public accounts are completely opaque and incomprehensible.

**Q111 Chair:** So, that is your ambition. In terms of the draft legislation, what is not in there that you would want in order to realise that ambition? **Jessica Crowe:** Something about the NHS and how health bodies are going to be tackled.

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

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

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

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

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

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

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

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

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

If you asked yourselves the question, as I am sure you will be asking other witnesses, “Who is now responsible for value for money in the local space?” you will get a cast, literally, of thousands, from the NAO through to the members of audit panels and auditors themselves. There is no obvious mechanism now for linking up the work that auditors do with the thrust to secure, for example, benchmarking material that would allow you to say whether a given public body or local authority is spending that money as effectively as possible. You could argue that at this moment we can least afford that potential for waste. To add to that briefly, let us not forget that the Audit Commission—according to the 1981 Act—was not really about VFM; it acquired value-for-money duties as the years went by, under the Conservative Government and under the Labour Government. It established a regime, now thought to be excessive, for looking at public services in the round, in the shape of the comprehensive area assessment. That was intended to be a mechanism for demonstrating to local people and local elected members that the spending they were doing matched up with the spending in comparable areas. Comparability remains the huge, huge issue in trying to see whether spending is being done appropriately. I cannot see, looking at the draft Bill, where you would extract proper measures of comparability and proper benchmarking that alone would give you, locally or centrally, a purchase on whether the spending is effective.

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

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

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

David Walker: I would give them a duty.

Chair: A duty.

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

I was personally against outsourcing the audit practice of the Audit Commission. The one point I would make is that when it comes to financial certification audit, the private audit firms are perfectly capable of doing that work, although in the past they were greatly helped by the framework set by the Audit Commission. They have got much less of a track record in the value-for-money area, and it seems to me that one thing that is happening in public audit is the rolling back of value for money. There is an interesting point about individual attention—about the
NAO not looking at individual local authorities. How can you give an assurance to accounting officers and to Parliament without any power in respect of individual local authorities?

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

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

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

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

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

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

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

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

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

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

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

I recognise what David Heald is saying: the audit of financial statements will kind of take care of itself, because it is core business and is well regulated. On the specific point of no surprises, just to share with you how it would work in Scotland, two points. I would regularly, personally, meet the auditors to understand the issues which are emerging and developing at the local level. From many years ago—although I was an honorary auditor for 12 years, as the Auditor General—I have a planning qualification and I am used to being asked, “What are you achieving? Stopping bad things happening?” There is an element of that around audit. The public value is to prevent mistakes and one can only do that by early conversations and detection. That is the first point. There is something about that “no surprises” which is really important, which we do have in Scotland. The second thing is that we are faced, as you can imagine, with the same pressures for efficiency. The way in which that is happening in local government is that we developed a regime which provided for a joint risk assessment of each local authority—each of the Scots local authorities—prepared by Audit Scotland, if they were appointed auditor, and the firm and also the inspectors, and they would work with the management of a local authority to do that. So it would be an agreed document. That shared risk assessment now informs and shapes the audit work and it has also helped us make the scrutiny work more proportionate, because you can concentrate on issues that matter. It does not mean that something will not
jump out of the woodwork, but nevertheless it is a system that kind of tries to manage that.

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

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

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

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

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

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

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

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

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

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

Q124 Mark Pawsey: Can I ask about the deterrent effect of the auditor? One of the reasons the audit is there is that the police and people know that if wrongdoing takes place the auditor will find it. If it becomes known that there is a less stringent regime, with less value-for-money work being done, is there a danger that those who might be contemplating doing something inappropriate are more likely to proceed, in your view?
**David Walker:** That has to be the case, otherwise why would we employ police officers, even if reduced in number? Again, you might privately ask the Chair and Clive about their experience a generation ago—as it were, in terms of municipal history—and the role of the district auditor in crimping the activist authorities of the day. I think it is having in mind somebody who has an interest in the local public good. Again, not to say that private auditors would not have that, but the belief under the previous regime was that district auditors were there, as I said, to carry out a civic purpose. Take that away and—

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

**Q125 Mr Bacon:** I wanted to ask about the capacity of Audit Scotland, Mr Black, and the references made earlier to the National Audit Office not having a direct connection with the auditors in the same way. Could you just paint a picture for us of the shape and size of Audit Scotland when you were there? How many staff were there and how many were devoted to Scottish Government audit, whether financial or value for money, and how many devoted to local government? **Robert Black:** Up until about three years ago, there were roughly speaking—the scale is entirely different—about 200 of us doing financial audit in Audit Scotland. **Mr Bacon:** In total? **Robert Black:** Yes. My colleagues and I committed ourselves—we could see the way the wind was going with public spending—to a 20% real efficiency saving. By the time I left in June we were well through that, so the financial audit staff numbers had come down to about 160 or something like that.

**Q126 Mr Bacon:** And of those how many were doing national Scottish Government work and how many were doing local? **Robert Black:** There would be a team of auditors who primarily do the Scottish Government resource accounts and who would also do a few of the large agencies. On orders of magnitude, maybe 10 maximum would be in such a team—I am sure that Audit Scotland could give you exact numbers now, because I am not up to date with this. There might be about 50 or 60 of the total staff who were working on overall performance audits, value-for-money audits or best-value reviews of local authorities. About two thirds of all the work, whether financial audit, the best-value reviews of local government or performance audits, was done by in-house staff, and about a third of the audits were done by others.

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

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

**Q128 Mr Bacon:** Were most people doing a bit of both? **Robert Black:** Not most, but a significant number were doing a bit of both. If we were doing, let us say, a major performance review of drug and alcohol policy in Scotland, we would be drawing on people with expertise in health, people with expertise in local government or people working at the centre—people would be working on mixed areas of work with that. So I cannot give an exact figure, I am sorry for that.

**Q129 Mr Bacon:** The analogy is between Scotland and England, which is roughly 10 times larger and where you have 800 or so staff—slightly less than 850 at the moment, I think—of whom a couple of hundred do performance audit and the other 600 or 650 do financial audit. That is all of central Government and its agencies—none of it is related to local government. There is none of this direct connection that Professor Heald was referring to earlier, so it is all very well to give the National Audit Office a duty, but the question is whether it would have the capacity as presently structured to take on something of that size. If England is roughly 10 times larger than Scotland, at present there is no capacity in the National Audit Office to have this direct connection with local government audit. **Robert Black:** May I give you one more piece of information that might be helpful? The budget of Audit Scotland is about £27 million a year. We do all of the work out of that total. **Mr Bacon:** The budget of the NAO is about £70 million or £80 million, and that does not include any local at all. It strikes me as unlikely in its present constitution the NAO would have the capacity to take on all this additional work.

**Q130 Chair:** What do you feel about that, as it is a key point? **Robert Black:** My comment is an obvious one. It would be for the Comptroller and Auditor General with his team to think about relative priorities, in consultation with yourselves. We regularly had to do that with the Public Audit Committee in Scotland, to cut our coat to the cloth.

**Q131 Mr Bacon:** To use your own phrase it is an order of magnitude difference, if there is all this work that is not going on at the moment. **Professor David Heald:** I would argue strongly that that is a matter for Parliament; most directly a matter for the Public Accounts Commission and the Public Accounts Committee, in conjunction with the Comptroller and Auditor General, to think about. We are where we are now, having effectively abolished the Audit Commission, and lost its capacity. The question about where capacity ought to be rebuilt is a
Q132 Chair: We are, but we are interested in your views. Richard Bacon is saying that it is such a qualitatively different set-up. Can the NAO do both? **Professor David Heald:** Obviously it can’t do it without more budget. That is an obvious point. I find it astonishing—

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

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

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

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

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

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

**Robert Black:** Oh, gosh. On the record, David, thank you for that passed ball. I prefer not to go there. There is something in there. To generalise at a philosophical level, there is something very much around the accountability of the auditors to the public. It has always struck me that within England, given the large and complex state it is, there is something about the regional dimension of transparency and accountability to local communities, but doing that in a way that is structured. In other words, for example, the opacity and the arcane technology of doing audits are difficult for the public to understand, not least under IFRS. Therefore, it was a core purpose of Audit Scotland, where possible, to attach meaning and significance to that in lay terms by putting a lot of emphasis on plain English final reports, which were very short form. Of course, that resonates at the level of Scotland, because it is like a large region, so there is something about that lacuna at the sub-national level, but I would prefer not to say more than that.

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

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

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

Q136 Mr Bacon: The answer we often get is that the question is whether the systems were in place. It is always systemic and always everybody’s fault. The issue that would concern the public is if, in the absence of the right regime—I do not pretend to have all the answers to this now—more Doncasters happened, and they did not get known about until it is, as it were, too late. So, they did not get known about until they were already extant and happening, rather than there being an early-warning system. How do you see the installation in the Bill of a sufficient early-warning system?

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

Research has been done in some private firms into how the top FTSE 100 and FTSE 250 companies work. It is all about the ‘tone from the top’, as they call it. It is all about how a local authority assesses itself, what local authority members do, and what the chief executive, senior officers and statutory officers do. There may be something more about the powers and roles of the statutory officers, because they are very important. Part of the intervention in Doncaster was absolutely to reinforce the powers and responsibilities of the three statutory officers, because they were what members were effectively ignoring. There may be something around enshrining that, and maybe the triumvirate of the head of paid service, the monitoring officer, and the section 151 officer. That
then may be a connection to reinforce some of those issues, but it cannot really be done by audit.

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

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

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

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

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

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

Q140 Chair: Because?

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

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

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

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

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

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

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

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

Jessica Crowe: That is the real challenge at the heart of this whole drive towards transparency. If people cannot understand it because it is all so complicated,
it is not going to achieve that policy objective. There used to be public reporting awards that David and I sat on, but they were dropped.

Mr Bacon: Was this armchair auditor of the year?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Robert Black:** No.

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

**David Walker:** No.

**Jessica Crowe:** Nothing from me.

**Chair:** Thank you very much. Those of us that are not on the CLG Committee found that helpful and useful in getting our brain around the issues. I am really grateful to all of you, and particularly grateful to David Heald and to Bob Black for coming down from Scotland.
Tuesday 6 November 2012

Members present:
Margaret Hodge (Chair)
Mr Richard Bacon
Mr Clive Betts
Meg Hillier
Mark Pawsey
Valerie Vaz
Heather Wheeler

Examination of Witnesses

Witnesses: Carolyn Downs, Chief Executive, Local Government Association, Stephen Hughes, Chief Executive, Birmingham City Council, Steve Parkinson, National Executive Council Member, Society of Local Council Clerks and Joanna Simons, Chief Executive, Oxfordshire county Council, gave evidence.

Chair: We are now in session. Meg wants to declare an interest.
Meg Hillier: I need to declare that my husband works for the Local Government Association, but he does not deal with audit.

Q152 Chair: I welcome you all. Thank you very much for agreeing to come this afternoon. We have about an hour for this session and then we move into a discussion about health. I am grateful to see you all. I am going to start with a general question, so whoever wants to tackle this one, feel free. Let me contextualise it. Our job is to look at the draft Bill as it is currently drafted and to see what gaps there are and what amendments we think we should propose to the proposed legislation. So that is where we are. On the whole, you are a bunch of people who welcome the change. That is how we have tended to see it, but even in that context, can you tell us where you think the risks and gaps remain in the draft Bill? Carolyn, do you want to start on that?
Carolyn Downs: I am happy to. Thank you, Chair.
One of the real risks is that there is a clear divergence in view about the need to have independent appointment panels—for the local auditor to be appointed independently by a panel. Over 80% of local government is saying that that is just not practicable to do. If you are in Oxfordshire or Birmingham, it will probably be much easier for you to find people from whom you will be able to choose independent panel members. If you are in a rural district area, you will find that much more difficult. There is a real divergence between the local government view and the central Government view about that. One of the things it would be useful to explore is whether a middle ground can be achieved.

Q153 Mr Bacon: May I stop you there? Just so that we are clear, can you describe, assuming it were possible—some people think it is; some people think it isn’t—to appoint an independent person to an audit panel, what sort of person one would be talking about who would be—
Carolyn Downs: Could I come in with an example?
We have had an independent representative on our audit committee for the last 10 years in Oxfordshire. When we started this, we were trying to recruit more than one independent member. We failed in that. If a major university town has difficulty finding somebody with the right background, it is going to be very tricky to do so in areas that do not have access to the sort of people who might be interested. For example, our audit member happens to be somebody who is a qualified accountant, with an academic background, who is interested in local government finance, so we are doing pretty well, but it was hard going for us even to get that.

Q154 Chair: So what do you suggest should be in the draft legislation? What is the compromise? If it was hard for you to get that and, as I understand it, local government does not want a second tier, a separate local audit committee or whatever it is, what is your answer to that?
Joanna Simons: There are two aspects. In terms of having a panel, most authorities have got an audit committee, and that is certainly something I think we would all say—

Q155 Chair: But as I understand it, the audit committee members are local authority members, so in an authority with 100% one-party control, that does not give me, as Chair of the Public Accounts Committee, much confidence that there is real independence.
Carolyn Downs: I understand the issue about independence, which relates to whistleblowing and so on. One of the ways you can achieve independence, given the divergence of opinion, is to think about a sector-led approach where there is a body that could do the procurement and commissioning of audit. It is just a thought, but at the moment there is such a huge divergence of opinion—

Q156 Chair: It sounds like the Audit Commission mark 2.
Carolyn Downs: You said that we were all in favour of the abolition of the Audit Commission. I think it is important just to state clearly our view—certainly what the LGA's position was. The LGA campaigned actively for removal of the CAA and top-down inspection. I do not think the appointment of auditors was an issue on which we campaigned, actually.

Q157 Mr Betts: I think it probably was. I think the LGA, when it came to give evidence to the Select Committee, was pretty clear that it wanted individual authorities to appoint their own auditor. I may be mistaken, but I feel sure that was the evidence you gave us.
Carolyn Downs: Given the current legislative framework, in which we are now operating, that was without doubt our response—that there should be consistency in central Government policy, and that different public sector bodies should be treated similarly. So, if further education colleges and NHS trusts are allowed to appoint their own auditors, then local government should be allowed to appoint its own auditors as well.

Q158 Mr Betts: Let’s say that this is one thing, but getting things right is another, maybe, in terms of local authorities and local government. Is the LGA coming to us today and saying that you would be equally satisfied with a regime where there was a body appointing auditors, as long as it did not have all the trappings of the CAA and all the top-down targets and things associated with it? If it were a body, as exists now with the Audit Commission, that simply appointed auditors at very good rates, you would be content with that?

Carolyn Downs: What I am saying to you is that, given that there is such a divergence of opinion between the positions of central Government and local government, a middle ground between the two needs to be explored. I am clear that the LGA’s position is that local government, like other parts of the public sector, should be able to appoint its own auditors. If the Government are insistent that we have independent audit panels, we think it is impractical and is not going to work, and therefore there needs to be a discussion.

Q159 Mr Bacon: I did not really get an answer to my question. The description of independent audit panels given to us last week in this Committee made it sound as if they were possibly an unnecessary adjunct; that they were superfluous, perhaps. But that is currently what is in the Bill, and your suggestion is that that be deleted.

What I am trying to get to is, if it goes ahead and does not get deleted, who would such people be? Miss Simons, in answering the question, basically said, “Even in the best of times, we find it extremely difficult.” What I am really after is not, “It can’t be done”—it can always be done if you try hard enough and devote enough resources to it—but, “Who would such people be if you were required to do it?”

Carolyn Downs: When I was required in central Government and to appoint independent people to the audit committee, we asked for people who had public sector experience—

Chair: Hang on a minute. I am going to bring in Stephen, because that is very different.

Q160 Mr Bacon: My question is not about central Government but about local government.

Carolyn Downs: I am giving you an example. Presumably, one would use the same kind of criteria. One would ask for people with appropriate experience as finance directors in a public or private sector background to sit on your audit committee.

Q161 Mr Bacon: Or people in local government. I can think, in our local rural district council, of an ex-district councillor—who is a technical accountant. There are lots of people like that around across the country; they are not only available to central Government.

Carolyn Downs: No, but one needs to determine whether they would be prepared to do it or not. That is a different matter. When local government has appointed independent people to its standards committees in the past, to be honest, it has been difficult to get people. They get very little remuneration for it, and to get the kind of people of the standing that—

Q162 Chair: We have a lot to get through. I am going to bring in Stephen Hughes and then Joanna Simons on this, and then I want to go back to Carolyn for other gaps, because we are dealing with the first one.

Stephen Hughes: I think the starting point is that I would like to be able, as a large local authority like Birmingham, to appoint our own auditors. I do not see the risks that you see.

The interesting thing about who the independent members are going to be is that if you have a one-party council, presumably, the councillors are appointing the independents on the audit committee, so if they really want to rig the selection process, they can always pick independents whom they like in order to get the decision that they want. Having independents on the panel does not protect it.

Q163 Chair: I accept that as a criticism of the Government’s proposal. Our interest, certainly in the Public Accounts Committee—that bit of Parliament—is to ensure that proper independence is built into the structure.

Stephen Hughes: First, you will have to choose them from an approved list. They have to reach certain standards before they can be chosen. Secondly, they have their own professional standards to which they have to adhere. If they do not adhere to them, they will be struck off from both the lists and their ability to do audits generally. Auditors of public and private sector bodies have to demonstrate their independence.

Q164 Chair: Let me just come back at you on that one. We are aware of that. The auditors you yourselves chose to appoint—we accept that it is very difficult to get an independent way of appointing them within a local authority, because you can fiddle it. That is what you have basically said to us.

Stephen Hughes: Well, if you are really that determined.

Q165 Chair: You can rig it is probably a better way of saying it. If that is the case and the auditors decide, however qualified they are, to do a critical report of Birmingham City Council, which your members do not like, the council can decide to get shot of them.

Stephen Hughes: There is a process for getting rid of them, which is complex and long-winded. It is more likely that they would not get an extension to their contract, or something along those lines. But we have
our own public obligations when going through procurement exercises. We have to demonstrate that in taking decisions around procurement we achieve value for money and so on—

Q166 Chair: But you yourself have admitted—
Stephen Hughes: As you know, we are not taking into account irrelevant considerations.

Q167 Chair: But you have yourself admitted that they may not get re-appointed.
Stephen Hughes: No, I am not saying that. I am saying that one of the things that would be irrelevant when making a decision about a procurement process would be that you did not like the reports that they wrote.

Q168 Chair: And who would challenge that?
Stephen Hughes: The auditors themselves would be able to challenge that through judicial review if they wished.

Joanna Simons: I support many of the things that Stephen has said. Another issue, which is something that is not included in the Bill, is rotation of auditors. Personally, I do not think it is a good idea that there could be unlimited extensions, because that potentially allows for too cosy a relationship, and not enough challenge. One of the checks and balances in the system at the moment is in fact that five-year rotation. Currently we have the chance for a bit of an extension, but personally, and I think many of my colleagues will say the same, I believe that it is a fundamentally sound thing that there should be a rotation.

I recently chaired the board of governors of one of our local universities, which appoints its own auditors. Having that rigour of rotation is very sensible. I think that provides a very strong check and balance. The other thing to be conscious of is that we are in a very transparent era. We cannot move for freedom of information requests on everything we do. The press have a powerful part to play. I understand that you have a concern where there is an authority that is a single party. There are not that many of them. Certainly the vast majority of councillors are not in that position. Opposition members do put a challenge in. Clearly you have to think about all the potentials, but I do think that rotation is something that could be included, and that would put a very strong check and balance in. These are major firms, after all, that are qualified in terms of audit. As for the likes of KPMG and others, if they lose one bit of business, they will get another, but it would be better if they rotated anyway.

Q169 Mr Betts: It is not just about appointments. It is about whether they are prepared to be really critical and whether they have the confidence to stand up not just in authorities where there is only one party but where there are very powerful individuals who want to put pressure on and try to exert influence. Let’s think of Westminster a few years ago. Do you honestly believe that an auditor appointed by Westminster—without any external backing or support—would have carried out the forensic, detailed and long-running inquiry into what was going on there?

Joanna Simons: You are taking out of context one example from more than 20 years ago in Westminster that undermines the rest of local government. If you look at the number of local authorities that are in the country, very occasionally there has been a bad apple. I would point back to Westminster. I was not working at Westminster, but I like to hope that if I had been there at the time—if I had been chief executive—I would have followed the statutory whistleblowing role that I have personally, as do my section 151 officer and my monitoring officer. We are professionals within this. With all due respect to you politicians, we do have a whistleblowing role, and on occasion different colleagues around the country have used it if there has been a problem like that. There is a danger that you undermine the professionalism and the credibility of the staff working in local government.

Q170 Mr Betts: I was not; I was simply saying that surely the audit process is a further check. Of course, the professionals themselves are there. Westminster was one example 20 years ago, but surely we have to have a system that is robust enough to deal with such an example if it occurs again.

Joanna Simons: But we are in a world that is much more regulated than it was 20 years ago. There is much more transparency and more openness than there was 20 years ago, out of all comparison to the situation there.

Q171 Chair: You two are here because you are exemplary local authorities. Some of us think about some of the local authorities we come across. I have a 100% council, and it is very difficult, in that structure, to find real, objective assessment that is not politically controlled.

Carolyn Downs: Among principal councils, there has only been one report issued in the public interest since 2010, and that was in Wirral council. That was a council where, as the body responsible for sector-led improvement, we were already engaged, and we worked with the auditor on that very same report. To put it in context, in a principal authority, there has only been one report in the public interest in the last two years.

Q172 Chair: Mr Parkinson has not had a chance to say what his proposition is. You are talking about a sector-led body, aren’t you?
Steve Parkinson: Thank you very much, Chairman. Yes, the proposal from the Society of Local Council Clerks and the National Association of Local Councils is very much about having a central body, although we have tried to avoid using the word “central”. It is certainly not about recreating the Audit Commission; the idea is to have a procurement body. I could reiterate the comments about independent members. Obviously, from the principal authorities’ point of view, there are perhaps 800 larger authorities which might be appointing audit panels. For 10,000-plus smaller bodies, if they could get one extra volunteer, I am sure they could find far better things
for that volunteer to do than simply sit and help appoint an auditor.

In addition, the proposal is that, by having one body, you have one person writing a standard contract and one person supervising a procurement process, and you have the economies of scale. But a parish council, perhaps with a turnover of £50,000 to £100,000, is going to struggle to get an appointed auditor at a reasonable cost.

The idea is not to recreate the Audit Commission, but as a procurement mechanism, a body that is owned and operated by the local partners gives us localist control. It also gives independence, because out of the 10,000 parish and town councils, there is only going to be, perhaps, a board of 10 people managing the organisation. That gives a kind of distance so that the body is not directly involved in the process.

In terms of the gaps that produces, the real risk, certainly for the smaller bodies sector, is that if anybody opts out and chooses to do their own thing, there is no central list or way of making sure who has actually submitted their returns and who hasn’t. There is a danger that, in separating things and taking a localist approach, you end up with people falling through the gaps, and unless somebody in the local community picks that up and says, “Actually, I’ve noticed my council hasn’t been audited for the last five years,” it is quite possible that that will happen.

Q173 Mr Bacon: And there is no systematic way of picking that up.

Steve Parkinson: If the body we have proposed setting up actually did appoint for everybody below the £6.5 million threshold, or whatever the threshold turns out to be, it would clearly be operating on behalf of them. But we have put forward an opt-out clause so that if people decided that they could undertake the exercise for themselves, they are at liberty to do so. I would have to say that the council I work for turns over something like £700,000 a year, but looking at our audit fees, you would be asking me to carry out a complete procurement exercise for about £160 if I was going to save money, and that is quite unrealistic in terms of the time I would take to write an audit spec, which I have never done before, and which I would hope never actually to have to write.

Q174 Heather Wheeler: I am a vice-president of the LGA, so I had better get that on the record. I used to be a parish councillor, and I seem to recall that when our parish council had its audited accounts and in-house audited accounts, we lodged them with the district council every year. Whether that was best practice or we were meant to do that, I do not know, but I am sure that we lodged them with the district council.

Steve Parkinson: That was the process until about 2002, when the lighter touch audit was brought in. Generally, the auditor who was dealing with the district council would also operate on that basis, and they would see the entire set of books. The current system is that there is a very standard form, where the accounts are completed, and there is a collection of declarations made by the council. It is signed by the responsible officer of the council to show that the accounts are right, it is approved by the council to be submitted for audit and it is signed by the internal auditor—all parish and town councils should have an internal auditor who is reporting to the council on any weaknesses in their governance. It then goes to the appointed auditor, who takes a very high-level overview of whether there is anything in the accounts they are unhappy with, and, each year, they ask for a selection of information to support the accounts they are seeing, just to give them a flavour of whether everything is operating smoothly. That is how the lighter touch regime operates on a considerably cheaper basis than having an auditor sat there going through everybody’s books individually.

Q175 Chair: We have a lot to get through, but I want to get a yes or a no from both Joanna Simons and Steve. Do you accept Carolyn Down’s” proposition that there ought to be a joint-purchasing entity?

Stephen Hughes: For Birmingham, we will go along with it if it is necessary. We can do our own procurement. We are a massive organisation.

Q176 Chair: So you are not really bothered. It is not major.

Stephen Hughes: No, but I can understand the issue for district councils and smaller councils, where there are some real benefits in having scale procurement. More likely, if we had the freedom, we would put out a framework agreement and invite other people to come along, but we have the capacity to do our own procurement without any difficulty.

Joanna Simons: We are in a similar position. We could certainly offer a framework to our district colleagues. That is one of the things where there is a gap in that overview. It is the same with the health service. Certainly, anything that keeps procurement costs down has got to be sensible. One of the good things in the past few years has been the downward pressure on audit fees. We are all concerned in today’s environment about seeing money going up in that when there are an awful lot of other things to worry about.

Chair: I am going to move to Meg on benchmarking.

Q177 Meg Hillier: One of the interesting discussions that we have been having is about the role of the NAO in this new structure. If the NAO will not be identifying improvement areas, how will the LGA identify areas for improvement? You have some tools, but could you outline your approach?

Carolyn Downs: If I could clarify the issue where we have concerns about the role of the NAO. It is on the drafting of the Bill at the moment and what is meant by the word “improvement”. From the fact that the NAO will be doing studies and thematic studies in local government, we would hope that it will consult with the LGA and therefore the sector on what the content of those studies might be. We would have some serious concerns if there was any mission creep that put the NAO into the whole role of sector-led improvement, which has clearly been pushed to the LGA and the sector to take forward. We do not have an issue about a small number of studies that the NAO will conduct each year; we are more concerned about
the NAO moving into the wider improvement agenda and working directly with councils, rather than looking at the systematic approach that CLG should take to ensure that the system is in place to give assurance through the accounting officer to Parliament.

Q178 Meg Hillier: Ok. If we talk about self-regulation and the sector-led improvement approach that you are suggesting, you have this LG Inform, which is part of that. How much does LG Inform currently cost and how you will fund that work in the future? It would be helpful to know.

Carolyn Downs: I am really sorry, but I do not have the cost. I can provide that to the Committee, as well as its future costs. We have put together LG Inform and most of it is brought through data that is available through councils and other inspection regimes. It pulls it all together as benchmarking data, which can be manipulated by the council and other councils. That will go public and be available to the public in probably spring or summer next year, once the IT platform is available. That will be a publicly available tool.

Q179 Meg Hillier: Just on the data first of all. How are you ensuring that local authorities collect data in the same way? Once the national audit is gone, there may not be the same drive to have standardised data. Is that something that you are asking people to comply with voluntarily?

Carolyn Downs: Yes, absolutely. In many respects, some of that data is still collected in a standard format.

Q180 Meg Hillier: There is no requirement for that to happen in future.

Carolyn Downs: I do not know whether there are statutory requirements, but a lot of that data will come from DfE data, so that will be done in a certain format. Others will be done through Health. There are various bodies to which we report as local government. There are some that are completely standard, but for others we ask for people to provide the information in a certain way. We do not require them, but I am not aware of anyone who is not prepared to.

Q181 Meg Hillier: So what is the sanction if a local authority—say Birmingham or Leeds—takes off in a different direction?

Carolyn Downs: There is no sanction.

Q182 Chair: How many local authorities are not members of the LGA?

Carolyn Downs: Two.

Chair: Only two.

Q183 Meg Hillier: What size are they? Are they district?

Carolyn Downs: One is the London borough of Bromley, and the other is Slough.

Q184 Chair: How many get involved in all your peer review stuff? What proportion is it? It is only 20% or something, or am I wrong about that?

Q185 Meg Hillier: We need to unpick this. LG Inform is one of your ways of doing some benchmarking. Only 300 so far are involved in LG Inform.

Carolyn Downs: That is right.

Q186 Meg Hillier: What is the roll-out plan, and is there any compulsion?

Carolyn Downs: We have no compulsion. This is entirely down to individual councils.

Q187 Meg Hillier: Do you have a feel for whether this will be taken up across the board?

Carolyn Downs: We hope that we will get to a much larger number. The large councils will all be involved in LG Inform. The smaller district councils will be where there is a gap.

Q188 Meg Hillier: Can I go back to the cost? What is the cost for a local authority to join up to LG Inform?

Carolyn Downs: It is part of our free offer. There is no financial barrier. We actually provide that entirely.

Q189 Meg Hillier: But there is a time cost in putting across the information?

Carolyn Downs: We load all the information into it. It is down to councils to be able to manipulate that information. We actually provide that entirely.

Q190 Meg Hillier: So actually it could be a useful tool for small authorities—

Carolyn Downs: We do not do it for town and parish councils.

Q191 Meg Hillier: Not town and parish councils, but it could be useful for the smaller districts.

Carolyn Downs: Yes, it should be. Many use it very actively. Backbenchers use it. In terms of holding the council and its performance to account, it provides a useful tool for backbenchers to do that independently.

Q192 Meg Hillier: That brings me on to two things. Picking up on the numbers issue, is there a point at which if you drop below a certain number of authorities being involved in LG Inform it becomes a less useful tool? Have you an idea of what you want as the ideal number of local authorities?

Carolyn Downs: To be honest, we believe that all councils should be involved in it. If it went below about 250, it would start becoming less useful. That is a personal view.

Q193 Chair: I do not know what 300 is as a percentage.

Carolyn Downs: There are 340. Over 95% of councils are using LG Inform.

Q194 Meg Hillier: Then there is how this information is accessible. You talk about it going on a public platform. We hear that all the time. We on
the Public Accounts Committee are quite in favour of open data and what the Government are trying to do on that. Frankly, though, half the time it is a load of data dumped on the internet. Even if you have some financial skills, it would be very hard to follow the pound.

Carolyn Downs: It is so good. I regularly use it when I visit councils. If I was going into a council, it would do the peer challenge of the council. It will tell me where it has high costs, high performance and low costs, high performance. It will tell you exactly whether they are bottom or top quartile cost and where its performance sits with that.

Q195 Meg Hillier: Perhaps Joanna, Stephen or you could give an example of a service area where you could go in and what sort of data you would find—perhaps it would be child care or social services costs?

Carolyn Downs: Yes, you would be able to find out about adult social care, whether a council is in the top 5% cost, whether its outcomes are in the top 5% or whether indeed they are in the bottom 5%. I was personally involved in a peer challenge of a very large county council recently, and that was precisely the information that we used to challenge it about its procurement and its costs as a council and whether it was driving its costs down in the way that other councils were able to because it was high cost, but its performance was the same as others.

Q196 Meg Hillier: Okay, may I touch on the issue of how robust and rigorous this is because it is voluntary? When it is working, it is great, but there is a threshold at which it may work less well. In terms of ensuring that it is delivering results, your peer review process is all voluntary because members can opt out. Birmingham or Oxfordshire’s large councils could decide that it was not useful for them or that they were being unfairly criticised—notwithstanding what Ms Simons was saying about the proper professionalism of officers. We saw something similar with the housing association model when the big 15 sort of floated off from the national body. They operate very independently now and do things quite differently. Is that a risk? Perhaps Joanna Simons and Stephen Hughes have something to say about that.

Stephen Hughes: The data are incredibly useful just for our own purposes. Given the pressures on local authorities at the moment, a good starting point is to understand where you are relatively more expensive or relatively better than other authorities in order to ask those questions. We are using that information for that purpose.

Q197 Meg Hillier: Do you use LG Inform?

Stephen Hughes: I don’t know the answer to that. I have people who—

Q198 Meg Hillier: You have people who do it for you. [Laughter.] When I was just a brand new councillor, Stephen Hughes was a finance officer in Islington, so we have both moved on.

Joanna Simons, do you use LG Inform?

Joanna Simons: I have to say I’m not sure, but the county council has been in the benchmarking club for some time. We have been paying outside bodies. What we have recently decided is that migrating across to whatever comes next is the key thing. We are certainly very keen on benchmarking.

If I can take it back a bit to where the question seemed to start, which was around the studies and other things, for most of us the worry is about being inundated with endless requests for additional data for things that feel a long way away from our priorities. That was the problem with the Audit Commission; it just got out of control in terms of the latest idea that might be fine in x part of the country but wasn’t relevant for us.

What we are really looking for is stuff that, when it’s really core things, some national work that goes on that’s useful, but locally we need to work on our own issues. Anything we can do to get standardisation of performance data is important. It needs to be honed down to the key things.

With the business about benchmarking, there is no value to anyone if there isn’t a consistency in terms of the kind of information going in. That has always been the search for the holy grail. Whoever has done benchmarking, whether it is the Audit Commission or somebody else, it is about making sure that it’s apples with apples and pears with pears.

As with Stephen, an awful lot of our day job is the hunt for continued efficiencies. That will not go away, so we are going to need this data for the future.

Stephen Hughes: The other point that I wanted to make is that, given the transparency agenda if you like, admittedly maybe we are not presenting the information in the most useful form, but there is a mechanism through that to ensure that local authorities start producing information on a basis that can be used by anyone. To be honest, that route would be preferable to having a body coming to us and directing us as to what pieces of information to produce and not to produce. Some of the stuff that the Audit Commission did was really very good, but quite a lot of the studies they did were useless.

Q199 Mr Bacon: Do you mean the value for money studies?

Stephen Hughes: Yes.

Q200 Meg Hillier: In terms of the Bill, because the National Audit Office will have some role in overview and sometimes in Parliament we need to get that broad overview to a body that is accountable to us, do you think the Bill is drafted correctly at the moment, in limiting the NAO’s role to a certain area of work, such as six studies a year?

Joanna Simons: Having now read—in great detail—the Bill and the guidance notes, the wording of the Bill itself seemed pretty wide. The guidance bit that went with it at the front was actually more framed. If we are talking about something that was how the Audit Commission used to be donkey’s years ago, when it did a few things a year, when they landed on your desk—in those days, they did land on your desk—you had time to read them, you took notice and you took them to committee. I can remember doing that back in London at a housing committee and justifying why Hounslow’s approach to void
properties didn’t match up with the ideal of the Audit Commission. It is scarred in my memory, from about 1990. What happened latterly is that there were billions of reports that nobody ever read, because there were too many of them and they weren’t high quality. If we can get back to a few key things, then I think we’ll have some substance, but the worry is that it will just be whoever’s latest idea somewhere that just gets imposed on everybody, which will completely waste time and discredit things when we need focus on the things that matter.

Q201 Meg Hillier: So you are saying that the guidance is better drafted almost?
Joanna Simons: What I am saying is this—the guidance is kind of clearer and tighter, and that’s the thing that’s important, whereas the wording felt very wide.

Q202 Mark Pawsey: Can I just ask you about the evidence that you have given us about LG Inform as a method of monitoring the performance of one local authority against another, relating it to the current Communities and Local Government Committee inquiry into the role of the councillor? We have had back-bench councillors talk to us about what they do as councillors and what attracted them to the work, but none of them has ever told us about the ability that this measure provides them with, in terms of holding their council to account; that is the back-bench scrutiny role. I had never heard of LG Inform either. How do you go about making certain that back benchers in councils know about it, because the LGA subscription is paid by the council? It is not a right available to the local authorities, because the LGA subscription is paid by the council? It is not a right available to the local authorities. It is not a right available to the councillors and what attracted them to the work, but none of them has ever told us about the ability that this measure provides them with, in terms of holding their council to account; that is the back-bench scrutiny role.

Q203 Mr Betts: The point has been made about the role of the NAO being to go back to where the Audit Commission used to be in the halcyon days that we were talking about. One of the Select Committee recommendations in terms of value for money was: “The NAO and LGA should lead on devising a coherent programme that adequately covers priority topics and avoids undue overlap.” Is that actually happening?
Carolyn Downs: I chair a reference panel in the NAO of officer colleagues from the sector, and we work with the NAO to choose the reviews that will be done. The next one, I think, will be on universal credit and its implementation and policy implications.

Q204 Chair: I will tell you my concern with all that. If local authorities determine what the NAO is going to do, you will hardly touch things. Universal credit is classic: it is not your responsibility yet, you can be critical of the Department for Work and Pensions and you can sit quite happily at the end of the report. What we want, in following the taxpayer’s pound, is to get assurance that the hard subjects are tackled. How are you dealing with housing repairs, for example? I am trying to think of big things, top things.
Carolyn Downs: The second topic to be done is adult social care, which is by far the largest proportion of spending in local authorities.

Q205 Chair: But there again—I can see where you are coming from, it will be a plea for greater resources from Government to fund local authorities. We want to get underneath, which is why I am slightly suspicious—I love local government but I am slightly suspicious—of a voluntary peer mechanism that is entirely led by local government.
Carolyn Downs: It is not entirely led. I chair a reference panel. It is entirely the choice of the NAO. So if you feel that it is making inappropriate choices, that is an issue for you to raise with the NAO. We say to the NAO that these are the issues that we feel are critical in our areas at the moment. Adult social care is nationally accepted as a priority issue that needs addressing—

Q206 Chair: For Government rather than local government.
I do not know what we do when you have got a sector-led approach and you do a peer-reviewed report but three councils refuse to publish.
Carolyn Downs: All councils have now agreed to publish—

Q207 Chair: What, Richmondshire, North Devon and Hambleton have published those peer reviews?
Carolyn Downs: To be absolutely honest, the reason why Richmondshire did not is that it was a joint council, with a shared chief executive and a joint review, and the whole arrangement had fallen apart when they would have undertaken the publication of the review. Anyway, it has now been published. Just to let you know, the one council that has caused more concern than any other—Wirral council—had its peer challenge last week and today it is publishing the review and its outcome. So we have really moved on considerably in terms of the whole issue of transparency around peer challenge. When I started at the LGA a year ago, I would say that there was some really deep cynicism about sector-led improvement in the sector itself. I think that has moved on considerably and tremendously, and the work that we have done in the Wirral has been exemplary. The fact is that it had its review last week, all three party leaders in the council agreed to the recommendations and to work on and publish them and today that review is being published.

Q208 Heather Wheeler: I used to undertake IDA peer reviews and thoroughly enjoyed it. It was the usual thing: you learned as much as you hoped to impart to the councils. I am interested and delighted to hear that it is now general business to publicly report them, because I do not think we did all those years ago, so things have changed. With the smaller councils, is there any cost-effective way other than
benchmarking? Do town councils benchmark with each other? Do parishes benchmark with each other? Joanna Simons: There are certainly some that do. For those that were in the Best Value 41 group, before parish councils ceased to be Best Value councils, benchmarking was very much something they did. The biggest problem is that if you look at two district councils or two county councils, they have a very similar level of functions—they have some options and they have different sizes—but if you look at two parishes of identical size, you might find for example that one had a cemetery and the other did not, one had a leisure centre and the other did not, one had playing fields and the other did not, or a market for instance. It really is apples and pears, with some bananas thrown in with such circumstances.

Q209 Heather Wheeler: Especially if there was a market.

Steve Parkinson: Exactly. I would say, from our perspective, in the 11 years I have been in the sector—I have been in the parish council sector for 11 years, I have been in local government for 25—we have seen huge changes to how things are done, and that has all come from the sector-led bodies, from the national association, the county associations and the society bringing together the professionals and looking at the very often difficult questions.

Q210 Heather Wheeler: So how do you feel the Bill affects governance and transparency for small accountants? As Madam Chairman says, we are here to find out whether there are issues where the Bill needs tweaking or whether certain paragraphs need taking out, because they do or don’t affect you, or because they do or don’t make it better.

Steve Parkinson: I cannot see the impact on them—in terms of the National Audit Office, in looking at what they would get from parish councils’ accounts, it would be very hard to do any kind of study on that and come up with useful information. I think if you are moving down to transparency, clearly if we are having a lighter-touch regime in that sense, it makes a huge amount of sense that information is published by parish councils. There is certainly a steady move towards people publishing information on websites, but I do not think that that is the be-all and end-all. If you take a very small parish of perhaps 300 people, actually they are much more likely to walk past the parish noticeboard next to the shop than they are to go online, thinking, “Oh, let’s have a look at the parish council website and see what they are doing.” At the very local level, sometimes a local and physical solution works. In terms of what is there, it seems about right for our sector at the moment.

Q211 Mr Bacon: I wanted to ask about specific cases where—I don’t know if you are aware of this—a local authority has requested the removal of an auditor because that local authority was concerned about the potential for the results of the audit reflecting unfavourably on it.

Joanna Simons: I am not aware of anything like that.
One of the gaps I was going to raise was that so much of this Bill is reliant upon the regulation that sits behind it. We will be extremely interested to look at the regulation that sits behind the Bill. In terms of the issue about the removal of auditors and whether there is any process of appeal etc., all of that needs to be properly covered in the regulation that sits behind the Bill to ensure that there are the appropriate assurances for local people, for yourselves as MPs and for councils.

Q217 Mr Bacon: One of the things that you said slightly surprises me, and it came up in a tangential way last week as well. Is it difficult to find out who the auditor is of a local authority?
Carolyn Downs: No, of course not.

Q218 Mr Bacon: Is it always available in a clear and easy-to-find space on the website of each local authority?
Joanna Simons: It will be on the authority’s website and in the accounts, which are published. I am pretty sure that everyone has a search engine on their website, so if you put in “auditor”, it should come up.
Stephen Hughes: They can always just ask us.
Carolyn Downs: I thought that bit in the reading last week was a little bizarre.

Q219 Mr Bacon: You said that we must make sure the public know who they are.
Carolyn Downs: You must make sure. I read that in your transcript last week, and there was a discussion about whether it was public information. Of course it is public information.

Q220 Chair: I accept that whistleblowers are few and far between, but the great thing about the Westminster case, which we touched on—I know it was a long time ago and things have got brilliantly better since then—was that if the Audit Commission had not stood behind what was a private district auditor, the question is whether the case would have been pursued. The risk of millions having access to his private audit form might put him off.
Joanna Simons: If we had a required rotation, even with that risk, the companies will be major organisations, and their specialists will not be some titchy little accountancy firm auditing a billion-pound business. It will be the likes of major accountancy firms. Even if they lost a contract, it would be only one and for the remainder of five years. If we had a rotation requirement, the risk would be pretty minimal in the scheme of things.

Q221 Mr Bacon: Do you mean because what they lost on the swings they would gain on the roundabouts in a cosy oligopoly?

Q222 Chair: I don’t think a partner in any of the major accountancy firms—I must say this, having worked for one of them—would allow you to risk £2 million or £3 million just to pursue public interest.
Joanna Simons: It should not be as much as that. Our audit fee this year is £250,000.

Q223 Chair: No, no. This is if you do a complex report in the public interest—

Q224 Mr Bacon: If you have to do some forensics.

Q225 Chair: Even at the time—it was a long time ago—it cost a couple of million.

Q226 Meg Hillier: Could I ask the two chief execs whether they have a contingency for this—or would they under the Bill—to pay for a public interest audit?
Joanna Simons: One of the big issues that people get frenziedly interested in is the fact that local authorities have certain reserves. We have a clear formula for those, but certainly if larger authorities had to make provision for that, they would be able to do so.
Stephen Hughes: The auditor would charge the fees back to the council.

Q227 Chair: I know, but just think it through. In comes the auditor and says that a report is required in the public interest on the way you have been handing contracts to X. He starts investigating, quickly builds up a bill for a million quid, and you will say, “Thanks very much, we’ll cover that,” and reappoint the auditor.
Stephen Hughes: No, of course we would not be happy about that, although it would depend on the extent to which the authority was wrong about what was going on. The fundamental issue is that if the auditors, when fulfilling their public duties as set out, find something, they are under an obligation to pursue it. They would be in dereliction of their own duty and professional standards if they did not. That is the challenge.

An entirely different case is Enron. Ultimately, the auditors found a problem sufficiently large that it broke the company and caused a complete change in accounting regulations. International accounting standards changed as a result of that case. Auditors acting without fear or favour is what you expect.
Carolyn Downs: In the case of Wirral council, we were working with it when its report in the public interest was issued last year. We were obviously having conversations with the Audit Commission in advance of that. The council has behaved in an exemplary fashion with publication of the report, and has taken the appropriate action. I anticipate that most councils would do so. We take sector-led improvement really seriously. We took that report in the public interest very seriously, and worked with the council on it. There are sufficient checks and balances. Local MPs in the Wirral have been very involved in the work that has been done in that council to take forward improvements, so there are huge amounts of checks and balances in the system. I understand your concern, but I think it is important, and there is always one case that proves the point, that we understand that, actually, the overwhelming majority of councils are behaving properly.

Q228 Chair: I am going to bring Mark in, but I just want to ask one more thing. There is now an increasing trend towards shared services. How do you see that being dealt with in the framework?
Stephen Hughes: Shared services are not much different from outsourced services. You have the same sets of risks and balances.

Q229 Chair: You have a lead authority.

Stephen Hughes: Well, you might go through a lead authority, or you might look at how the transactions are effected according to the individual component parts. So I do not think it is anything special or different that requires a different kind of legislation.

Joanna Simons: I would echo that. We have a number of different types of shared service arrangements with other authorities and other places. It will just be a question of what makes the most sense in that particular instance.

Q230 Mr Betts: As well as having joint commissioning, which we talked about, for managing county districts or different districts together to try to build up some capacity, is it possible to have joint audit committees, too?

Joanna Simons: Yes, that is possible.

Q231 Mr Betts: That would help with the problem of recruiting independence because you would have fewer bodies to recruit people to.

Joanna Simons: If you want to go down that line, that is possible, but one of my worries would be about what is proportional and what are the costs. If the issue is about the independence of procurement, it would make more sense to have some bigger framework contracts one way or another, whether it is the LGA doing it or, in bigger met areas or county areas, the upper-tier authority doing it on behalf of others. We want to try to keep the costs down, but certainly when we do joint things such as joint health scrutiny, it is a question of balance, not putting in too much bureaucracy and getting better value for money.

Q232 Mark Pawsey: I want to ask about the cost and quality of audit under the new regime. We heard evidence last week that the Audit Commission had done a fantastic deal and that the prices that are currently being paid are unlikely to be repeated. Presumably your opinion is that you can go out and do a very good deal, and, Steve, you represent lots of smaller bodies that are going to be concerned. So what is going to happen on cost? Perhaps you could also tell us what your views are on quality. If there are these highly competitive tenders for work, does that mean that audit is going to be done less thoroughly in the future than it might have been done in the past?

Stephen Hughes: Clearly we are a large authority, and we will probably get a keen price in the future any way. In fact, there is an argument that says that, if we had done our own separate procurement, we might have got an even better deal than the one in front of us. There is that risk that larger authorities are likely to get much better deals than smaller ones.

What we have noticed so far is a keenness to charge more regularly for stuff that is over and above what was in the standard contract. So there is already a new commercialism in the nature of the relationships.

Q233 Mark Pawsey: So are audit firms coming in at a loss on the main job and then making it up with extras?

Stephen Hughes: No. I am not saying that, but if we had not made up a set of notes to the accounts in an appropriate way, the auditor would say, “Well, that is going to take us another day’s work. Here’s the bill.” So they are being a bit sharper in what they are charging for and what they are accepting in terms of the standard stuff. Now that we know they are working in that way, we can work with it. In the long run, I think it is all going to be supply and demand, isn’t it? We know what the demand for auditors is. If we can increase the supply, and therefore keep the market competitive, prices will stay keen. If, on the other hand, it becomes a smaller number of large authorities—

Q234 Mark Pawsey: All right. What do you think is going to happen?

Stephen Hughes: I do not know yet, because I do not know what is going to happen to the market. There is a risk that people have bid for what they have bid for to get into the market with a view that there will then be a limited number of players in the next round and that they will be able to charge more.

Q235 Mark Pawsey: I take it from what you said earlier that you are very happy for your power in the market to be used to the advantage of districts and smaller authorities nearby.

Stephen Hughes: We are willing to do that if they are willing to. There is a bit of a danger that everybody thinks that, if we do that, Birmingham is taking over the world, so to speak.

Q236 Mark Pawsey: In which case, Steve, does that give you some comfort in terms of your anxieties about the fact that smaller authorities are likely to be, in isolation, charged a lot more than they are paying currently?

Steve Parkinson: There is a risk of that. Certainly, if parish and town councils were going through their own auditors—if you look at the bottom end there are now 4,300 under the new fee arrangement that will pay no fee at all because they are a council spending under £10,000. But the next band up—to £25,000—their audit fee is £100. That is a small amount of an auditor’s time to be cost-effective. Realistically, if they were going to try and go to the market and say, “We’d like an audit done”, they would be doing well to get that.

Q237 Mark Pawsey: So is it just going to be superficial? Is it so superficial that it is not worth doing, in your view?

Steve Parkinson: I cannot help feeling, looking at the figures we have got, that my own council will probably see something like a 20% reduction from the audit fee we have just paid to the audit fee next year under the existing regime. Those bodies at the bottom are going to—

Q238 Mark Pawsey: What would be the impact on quality of that?
**Steve Parkinson:** That is hard to say. I have heard an anecdotal comment. Somebody told me that their audit had been done by a graduate student who was not doing accountancy—they were doing economics or something. I do not know whether that is factually correct. But that is the kind of concern. You might get the most junior person you can find to do a quick once-over and send the forms back. There are certainly councils that think they are paying a big fee for a signature. They are convinced that they send the accounts in, the accounts sit somewhere for a month, then eventually get signed and sent back. I am sure that that is not what happens, from the auditor’s point of view.

Looking at the current fee scales for this year, which the Audit Commission has just published, the savings that could have been squeezed out of the market look as though they have already been squeezed out. When we get to the 2017 tender exercise, I cannot imagine those fees going down and, especially for the very smallest, I can see them needing to go up.

**Joanna Simons:** Can I just add a relevant point? It is unclear what will happen in the next procurement round, and to extensions. We will need some certainty about that, sooner rather than later, obviously.

On the quality of the accounts, some of it is also about how good you are internally. Our audit fee has gone down over the last 10 years as we have got better at doing our accounts.

**Q239 Mark Pawsey:** Because you prepare more information.

**Joanna Simons:** Absolutely. It is in our interest to be better ourselves, because that keeps the costs down. There is a different issue for small councils, which is that if you can procure on a wider basis, by whatever route, that makes a difference.

**Q240 Chair:** Okay. We are coming to the end. I have a couple of questions I want to pull together, and then Richard has one. Going back to the NAO, is there anything that you would not want the NAO to get involved in, in your local authorities? What would you not want them to do?

**Carolyn Downs:** I do not think councils would want the NAO to be involved with individual inspections of work in individual councils in any way, shape or form.

**Q241 Chair:** Would you expect the NAO, at all, to be involved in discussions with individual councils at any point?

**Carolyn Downs:** If they were following the money, which is a decreasing amount of central Government money as we go forward, we would expect them to have conversations to understand what happens with the money in an individual council. But the accountability to the NAO is from Bob Kerslake, as our accounting officer in the Department for Communities and Local Government.

Councils are clear that their accountability is to their local community.

**Q242 Chair:** Do you all agree with that?

**Joanna Simons:** Absolutely. The issue with the NAO is really what I said earlier about what happened with the Audit Commission. If this is at the level of doing core things that make a difference in value for money, that is fine. We do not want this to be drowning in the latest thing that somebody thinks is right, but is not right across the piece.

**Q243 Chair:** Finally, Carolyn, we stopped you at the beginning, but, very quickly, are there any other gaps?

**Carolyn Downs:** On the cost issue, it is not just parish and town councils where there is a real risk of increased costs; it is also smaller councils—district councils and some of the smaller unitaries. In the next procurement round, having squeezed 40% out this time round, there is a real need to do as much collective purchasing as we can to ensure that we get the best prices.

The other gap is the role and powers of the residual body, which are not referred to in the Bill as it is at the moment. I think we will, as John said, have some real interest in what the role and powers of that residual body are, through to 2017, particularly if those contracts are then extended—and what the requirements are for those to be extended right through to 2020.

**Q244 Mr Bacon:** Is the assumption that the body can just be made by order at the moment, under the present proposals?

**Carolyn Downs:** Yes.

**Q245 Mr Bacon:** So there is no need, they would say, for being specific, because it can be dealt with by regulation. Is that the stance?

**Carolyn Downs:** Yes. That is why I said to you earlier that the whole issue of what the regulations are, sitting behind the Bill, is so fundamentally important to us.

**Q246 Mr Bacon:** En passant, my impression is that the NAO is no more keen to see lots of individual studies of individual councils than you are to have them done. You are probably singing from the same hymn sheet there.

This is really one for Mr Hughes: it seems a shame for you to come all the way from Birmingham and not have an opportunity to refute this scandalous story in The Sun. It talks about Birmingham city council having an £11 million automated phone service that is sending callers mad because it cannot understand Brummmie accents. Apparently, it demands an account of the work there.

This is the latest thing that somebody thinks is right, but is not making any difference. One of your councillors, Councillor Mike Leddy, said, “I am a proud Brummie and most people can understand me”; but, “it kept saying ‘can you please repeat’.” Is this true?

**Stephen Hughes:** There are two parts to it. There is a front end, which gives you options for choices, but you do not have to speak—you can press the keypad.

**Chair:** Is “dialect” a choice?

**Q247 Mr Bacon:** Apparently, it speaks with a Geordie accent. Is that right?
Stephen Hughes: I do not know, I have not rung it up. There is a proposition we have not implemented about attempting to have an intelligent conversation with the person ringing in—the customer—to deal with the query or direct them to the right place. The reason we have not implemented it is partly to do with those kinds of issues and partly to do with ensuring that the systems are all properly integrated and that it actually works on a big scale.

Q248 Mr Bacon: When you say “those kinds of issues”, you mean that it is true that it cannot understand the accent? Stephen Hughes: I do not recognise the story as written. Is that today’s copy of The Sun?

Q249 Mr Bacon: It is today’s copy of The Sun, which says, “council deputy leader Ian Ward” confessed—he could have been confessing to something completely different; it is, after all, a newspaper, so only 50% of what you read is likely to be true, and the trouble is working out which 50%—“Our performance is a long way short”. Stephen Hughes: That sounds like half a quote, to be honest. I will have to ask him—

Q250 Mr Bacon: Unfortunately, they did not print the other half.

Stephen Hughes: There is always room for improvement in call centres, I would say. I will have to follow that up.

Q251 Mr Bacon: It is on page 17.

Stephen Hughes: Okay.

Chair: Thank you very much indeed for attending today. Many thanks for the very clear evidence.

Examination of Witnesses

Witnesses: Dr David Bennett, Chief Executive, Monitor, Richard Douglas, Director General of Policy, Strategy and Finance, the Department of Health, Sir Robert Naylor, Chief Executive of University College London Hospitals NHS Foundation Trust and Professor Peter C Smith, Imperial College gave evidence.

Q252 Chair: Welcome everybody. David Bennett told us that he would be a little late, so we will start without him. I am grateful to the rest of you for agreeing to come. We have about an hour. Our job is to look at the Local Audit Bill, as it stands, to see ways in which we would want to amend or augment it. We are asking our questions on that basis.

I shall start with you, Richard Douglas, with my Public Accounts Committee hat partly on. You have promised—we were trying to think on how many occasions—that the accountability protocols for the new health service, whether foundation trusts or the commissioning bodies, would be apparent by the time the Local Audit Bill emerged. There is absolutely nothing on the face of the Bill that tells us anything about how we will be able to follow the taxpayers’ pound and ensure value for money and probity.

Richard Douglas: First, may I apologise for the fact that the proposals around health have not been made public before this hearing today? We have been through a long period of consultation and discussion with the NAO, Monitor, the Treasury and the Commissioning Board, but that is no excuse—this should have been made public before the Committee met. The proposals are currently with the Home Affairs Committee for cross-government clearance, which will be by 19 November—but it should have been available before today.

Mr Bacon: You are talking about the Cabinet Committee, not the Select Committee of the House.

Richard Douglas: Yes, sorry, the Cabinet Committee.

Q253 Chair: It is deeply irritating, particularly because this is not the first time we have asked for it—we think it is the third time we have asked for it, from the Public Accounts Committee perspective. What, if anything, can you share with us that will give us satisfaction—I am sure Valerie will want to come in on health—that there will be adequate protocols and procedures in place for value and probity?

Richard Douglas: I can share with you the principles on which we based the proposals for the audit arrangements, and those areas on which there has been debate around whether they should be precisely in line with the arrangements set out in the Local Audit Bill or those on which there might be some modification. The basic principle that we have worked to is that we should follow the approach in the Local Audit Bill and that, as far as possible, we should mirror that in the arrangements for the code of audit practice, for the quality assurance and regulation of audit, for the scope of the audit and for the issues about appointment of auditors—so, as far as possible, to follow what is in the Local Audit Bill.

We have had some debate on two or three areas, because the arrangements are already in place for the NHS. First, on the code of audit practice, the proposal in the draft Local Audit Bill is that the NAO should be responsible for the code of audit practice that governs audit across local public services. At the moment, the code of audit practice for foundation trusts is a responsibility of Monitor. The debate has been about the extent to which we should mirror the principles and the rest in the Local Audit Bill—have the NAO to do a code for every body—or the extent to which we should have the NAO to do a code of audit practice to cover clinical commissioning groups, while Monitor continues to do it for foundation trusts. On the regulation of audit and the overall oversight of auditors, I expect the proposals to be entirely in line with the Local Audit Bill, using the Financial Reporting Council and the professional accountancy supervisory bodies to oversee that.

On the scope of audit, we expect it to be the same in scope as the Local Audit arrangements, covering not only the audit of the financial statements but also regularity of audit, compliance with authorities and
value-for-money audits. The only questions around that are potentially about what the reporting arrangements might be for each—what the precise form of reporting would be—but the basic principles are the same as in the Local Audit Bill.

**Q254 Chair:** Before we tease a bit of this out, when can we look at all this stuff?
**Richard Douglas:** By 19 November we expect this to have been cleared by the Cabinet Office, so on 19 November.

**Q255 Chair:** We have to report before Christmas, so we would want to have it pronto and then, if necessary, call you back if we feel that necessary.
**Richard Douglas:** Absolutely, I fully understand that, but 19 November is the date for clearance of this.

**Q256 Chair:** To tease out a little from what you said, it might be helpful now to bring in Robert Naylor. Also, thank you, David Bennett, for coming. Do feel free to comment.
We have had concerns, as David Bennett knows from the Public Accounts Committee, that at present it is not like local government—we had a little debate on this before we started—where there is a clear election system to pass judgment on an organisation if it fails to perform. We do not have that sort of democratic mandate. I know that there are elections, but they are of a very different nature, particularly in relation to foundation trusts. We have a concern about what mechanism should be in place, given that there is a complete vacuum in the Bill, in order to give the taxpayer assurance that there is both probity and value for money. I do not see, even from what Richard Douglas was able to tell us earlier, that the final arrangements will give us the assurance that we currently have in holding the Department of Health to account.
**Dr Bennett:** In terms of probity, the local audit is clearly very important. Foundation trusts appoint auditors—the governing bodies of foundation trusts appoint auditors, so it is an independent group that appoints them. We, of course, look at what the auditors say, as well as it being available to the governors and more widely. In terms of the overall performance, including value for money of the foundation trusts, that is our responsibility, so that is where—

**Q257 Chair:** Do you set an audit framework?
**Dr Bennett:** We do. We set the audit code for foundation trusts, so we define what it is that we want the auditors to look at.

**Q258 Chair:** So you can do the comparative study.
**Dr Bennett:** Absolutely.

**Q259 Chair:** Will you publish that?
**Dr Bennett:** The audit code?
**Chair:** No.
**Dr Bennett:** The audit itself? Yes. The audits get published.

**Q260 Chair:** Will you do some value-for-money studies, or do you expect the NAO to do those?
**Dr Bennett:** Across the system, we would expect the NAO to do that. In terms of individual trusts, looking at their efficiency, effectiveness and whether they are delivering their services economically is one of their current terms of authorisation. It will be in their licence going forward, and one of our jobs is to make sure that they are delivering on that requirement.

**Q261 Chair:** Can I just press you on that a little? When we did the financial sustainability of the trusts, I think you said—I can’t remember now—that there were something like 11 that would not.
**Dr Bennett:** There were then.

**Q262 Chair:** Is it worse?
**Dr Bennett:** It is 14 now.

**Q263 Mr Bacon:** That was only three weeks ago.
**Dr Bennett:** Not quite, but—

**Q264 Chair:** There are 14 that are either financially vulnerable now or that you would not have given foundation trust status to at this point. Again, I cannot remember which of those two statements is right. Is it the first or the second, or a bit of both?
**Dr Bennett:** In fairness, you would say both. The 14 are trusts that are in what we call significant breach of their terms of authorisation for reasons financial. By definition, were they performing like that at the point we were reviewing them for authorisation, we would not have authorised them.

**Q265 Chair:** There is a question arising out of that. We had the evidence last week from the ex-chair of the Audit Commission—I do not know if you had chance to look at that—who said that there has not been one report in the public interest coming out of foundation trusts. In local government at this point, if there was a local authority that was in any similar situation, the Audit Commission would have produced a report in the public interest. That makes us very uneasy about the proposed new arrangements.
**Dr Bennett:** I believe that is right. As a matter of fact, we have not been keeping a record of the PIRs, but as far as we are aware, there have not been any. We do not rely on the PIRs. The compliance regime we are operating, I would argue, is actually a more thorough review of what is going on in terms of the finances, and indeed, of other aspects of performance in the trusts, so it is us taking a view on the basis of the assessment that 14 of them are either in or heading for difficulty.

**Q266 Chair:** But there is no public interest report on that. So, Monitor—if you happened to be in front of the PAC or Valerie’s Committee, you might reveal that sort of information, but that is not the same as accountability to the public at large and a community.
**Dr Bennett:** Just to be clear, it is not only when I am in front of the Committees that this information becomes public. We publish it all the time. Every time we find a trust in significant breach in this category, that information is published by us. If things change
at the trust, we publish that information. When we believe that a trust has dealt with its problems, we publish the fact that we are taking it out of significant breach. So it is very much in the public domain.

Q267 Valerie Vaz: Just to get this straight, you look at the foundation trusts and you have a dialogue and discussion with them, so there is not any mechanism that you are using to make them accountable to you. Presumably, they provide you with a certificate of compliance, do they?

Dr Bennett: The way it works is that we monitor an array of metrics, some financial, some around the quality of performance and some slightly broader around their governance performance. There is a systematic process of these metrics triggering our intervention and our intervention is on a series of escalations, so first, even when we spot that numbers are deteriorating before they formally trigger these, we will start conversations with them to understand what is going on. If they formally trigger one or more of these metrics, then we have a more formal discussion with them to understand what the nature of the problem is. If we think that there is indication that they are not completely on top of it and about to address it, the board is brought in for a discussion about what is going wrong. At that point, we almost certainly will choose to take some form of intervention action, sometimes requiring them to get some external advice and maybe to appoint new or additional members of their board—right the way through to us actually firing people on the board, if we think there is a serious problem with the leadership of the trust.

Q268 Valerie Vaz: But none of that is public.

Dr Bennett: Yes.

Q269 Valerie Vaz: They are all behind closed doors.

Dr Bennett: No. Well—

Q270 Valerie Vaz: Your discussions—

Dr Bennett: The meetings are not public, but the conclusions of those meetings are totally public, so once we have had a meeting we write to the trust saying, “This is what we have concluded on the basis of this meeting.” That is partly so that they can have a period of time to respond. They may disagree with our reasoning. We provide a matrix of evidence that supports our conclusion. That is published, so it is also an opportunity for any member of the public to see what is going on with their trust.

Q271 Valerie Vaz: Presumably, this kind of framework will apply to each and every CCG—clinical commissioning group—and presumably to the NHS Commissioning Board. Is that right?

Richard Douglas: The CCG arrangements will be slightly different, in the sense that they are not regulated in the same way as foundation trusts are by Monitor. They will have the NHS Commissioning Board overall supervising, though. The NHS Commissioning Board will, first of all, set terms on which they will be authorised, which will include their arrangements around financial assurance and value for money. They will monitor them during the year. They will monitor compliance with those. At the extreme—

Q272 Mr Bacon: Sorry, who will? The board?

Richard Douglas: The NHS Commissioning Board will monitor those. There will also be separate external audit arrangements, in the same way I discussed earlier on, that comply with the principles based in the Bill. So there is a combination of external audit that gives assurance, but also the direct assurance from the Commissioning Board itself. The Commissioning Board is subject to assurance and review by the Department and to external audit by the National Audit Office.

Q273 Chair: Will any of these things, if the CCGs have financial difficulties, hit the public domain?

Richard Douglas: If the CCGs are in financial difficulty, yes, it would hit the public domain.

Q274 Chair: How?

Richard Douglas: It would hit it through the monitoring arrangements of the Commissioning Board—

Q275 Chair: So that would be public.

Richard Douglas: It would have to be elevated up to the Commissioning Board itself—whether there was a serious financial problem. The NHS Commissioning Board holds all its meetings in public.

Q276 Chair: And the NHS Commissioning Board would be under a duty to publish. At the moment, four PCTs are in financial difficulties. I am slightly going back into my memory and seem to recall that from the work we did.

Richard Douglas: Yes.

Q277 Chair: We know about it now. How will we know about it in the new world?

Richard Douglas: Again, as David said for monitoring foundation trusts, the information on the PCTs is put in the public domain every quarter, so there is a—

Q278 Chair: But under the new arrangements.

Richard Douglas: Under the new arrangements, the expectation would be that the Commissioning Board would make that publicly available.

Q279 Chair: I want to come to both Robert Naylor and Peter Smith, and then I will come to Heather. You have a blank sheet of paper at the moment, because the Department has failed to fill it in. In that context, from your perspective as a practitioner, and your perspective with all the experience you have, what should be in the regulations to give us comfort on probity, accountability and VFM?

Sir Robert Naylor: As far as foundation trusts are concerned, we have a tried and tested process of governors who are elected; non-executive directors who are appointed by the governors; and the establishment of an audit committee, of which both I and my chairman are not members, but which we are invited to in the event that the audit committee has
How many people come?

Sir Robert Naylor: At the last AGM I think we had about 120 people. To a normal meeting I would say probably about 30. Of course, my trust is very high profile and therefore there is a lot of interest in what is happening. Also, our board of directors meetings are in public. Both I and my chairman endeavour to put as much in the public domain as we possibly can. To come back to comments that David made a few minutes ago, I think it is important for public bodies such as foundation trusts not just to wait until David finds out that there is a problem. As soon as we identify that there is a problem, it is important that we put that into the public domain through our public board meetings and governors’ meetings. In the event that we think there might be a prospective problem in the future, but we are not sure about it, we declare that publicly and declare that to Monitor as soon as possible. I think that builds a strong bond of trust between governors and the board of directors, and I hope between the foundation trust and Monitor.

Chair: That is your view. I think about my own not yet foundation trust. I think they would be less willing to share that publicly. They would feel threatened.

Mr Bacon: The trouble is you are one of the leading chief executives of one of the best hospitals in the world, so you are looking at it from a perspective of best practice, and that is what you do. You walk your talk as a matter of course. So what you have just said—for you—is unsurprising. Whether everyone else behaves like you—or would—is really the question. That is what is not clear.

Meg Hillier: May I just ask, as an indication of what we could be losing here, when you have your open board meetings in your very big and, as my colleague says, internationally renowned hospital, how much do the media cover those meetings? If you have presented it in public in papers and then had a public meeting, would that hit the media?

Sir Robert Naylor: Less so in the board of directors meetings. We always used to have several members of the media there, but I have to say in recent times we have had less attendance at meetings, but we do send all our board papers to the media and we often get requests from the media subsequently about what happened.

Meg Hillier: Again, best practice is that you send it out. But if you were a foundation trust, as Richard Bacon says, and perhaps not so good, you might not bother to be as open about sending it out. In terms of local transparency, it sounds all very well, but actually a lot of the public do not turn up, and the media these days have fewer journalists available to turn up, so quite a lot could get hidden in that weight of paper.
when they seek to come to a view as to whether public money is being spent wisely.

Q286 Chair: Very helpful. Can we have comments from all of you on those points, because they are the key issues? Go on, have a go, and then Peter Smith can come back at the end, if he wants.

Dr Bennett: If I may, I will also pick up on Robert’s comments. All FTs are required to publish the minutes of their board meetings and are required to hold their board meetings in public. It is fair to believe that they will not all be equally proactive in putting that out there, but they are all accountable to their locally elected governors. That is a layer of governance.

Q287 Chair: But on the whole, just tell us—we had this discussion before—what proportion of the local population vote? Even if we accept that the turnout was—what proportion of the local population vote?

Dr Bennett: It is small, but they are there. They are there because they are proactively interested in their trusts.

Q288 Chair: But what is it? Have you looked at what it is?

Dr Bennett: I haven’t, no, but I accept that it will be very small as a percentage. Of course, it is the governors, not the board, who are appointing their own auditors. So in answer to Peter’s point, it is not the trust board appointing its auditors; it is the governors—

Q289 Chair: But the governors are a self-perpetuating group.

Dr Bennett: The governors are elected from among the membership.

Q290 Valerie Vaz: What do you do to pull all the information together? How do you stop a Mid Staffordshire, which you did not do?

Dr Bennett: As I said, we have this lengthy list of information, some financial, some quality and so on—

Q291 Valerie Vaz: I know you have the information, but what did you do? What could you do? You have the tools to do it, to pull together all this information within the foundation trusts, so that everyone knows about good quality, best practice, and perhaps to stop a Mid-Staffordshire. What could you do and what did you do? What powers do you have and what powers should there be to stop a further Mid-Staffordshire? We are talking about a third of the budget, aren’t we? The health budget is a third of Government spending, which is going to be dissipated among, well, we do not know who. PricewaterhouseCoopers; Grant Thornton?

Dr Bennett: I think most of it goes on staff at the provider trusts. What do we do? We collect the information, we monitor the performance using this information and, as I said, when we see things starting to go off track we will start to intervene, at an escalating rate depending on the scale of the problem. In the case of Mid-Staffordshire, we are of course waiting for Robert Francis’s report to come out, but I think it is fair to say that we did not intervene soon enough. I hope we will not make that mistake again.

Q292 Valerie Vaz: So why should we be convinced that public money is going to be properly used under this regime if everybody wants to follow Monitor’s regime? Will we have to have inquiries over all the CCGs that will misspend public money?

Dr Bennett: I cannot speak for the CCGs, but in terms of the FTs the compliance regime that we are operating should give you reassurance that someone is monitoring beyond the local governance arrangements—monitoring what is going on and stepping in when there are indications of problems.

Q293 Valerie Vaz: You had that and you did not do it, so why should we be convinced that it will happen under the new regime—which we do not know about? Mr Douglas, I have to say, you have been sent down from the Department of Health, but this feels so much like what happened with the Health and Social Care Bill—there was absolutely no information at all. I think it is absolutely disgraceful for a public Department to be in this position where you do not give information to the Committee. You are wasting everyone’s time. You really should take it back to the Secretary of State that we are not happy.

Dr Bennett: Just to finish with your question about Mid-Staffordshire. You are quite right, we did not do everything correctly at Mid-Stafs. We sought to change the way we do things, significantly, as a result, and if Robert Francis recommends further changes we will make those as well.

Q294 Valerie Vaz: So we have to wait for an inquiry before you make changes—

Dr Bennett: No, we have already—

Q295 Valerie Vaz: You are missing the point, Dr Bennett. I am saying that you have got this in place, and you are recommending this framework for the new regime, but you could not spot this—or you did not want to, or you had a discussion with someone behind closed doors. How is it going to work the next time?

Dr Bennett: Which framework am I recommending?

Q296 Valerie Vaz: The framework for the current audit of the national health bodies. Is not everyone saying, “Look at the foundation trusts, they have done this well, let’s copy what they are doing”? We don’t know, do we? Didn’t someone say that?

Richard Douglas: I do not think it is quite as clear as that. What we said is that at the moment, under these arrangements, we do not plan any significant changes to the audit arrangements for foundation trusts. The audit arrangements for foundation trusts have operated for a number of years, they seem to operate effectively and the only area where as a result of the changes we might be looking at some modification is in who sets the audit code. At the moment it is Monitor, but for every other public body in the new world it is the National Audit Office. So the foundation trust side is the only area in which we would envisage any change.
It would not be fair to say that David Bennett or Monitor have recommended this Foundation Trust approach across the rest of the public service.

**Q297 Valerie Vaz:** I am not saying that at all. We did not know, you did not give us any information, so we are trying to tease out what is going to happen.

**Richard Douglas:** As I said, it will follow the principles of the Local Audit Bill. An overall code of practice will be set for auditors; the expectation is that that will be set by the NAO, as it will be for local government. There will be quality assurance and regulation of compliance with that audit code, which we expect to be done in the same way as it is for local government. Within that, we would expect the clinical commissioning groups to be appointing the auditors to operate under the code. In that sense, you would expect it to be similar to the model for foundation trusts.

**Q298 Chair:** Each appointing its individual ones, not collectively buying it—not bulk purchasing.

**Richard Douglas:** One of the questions that we have to look at when we think about the benefits of local commissioners being responsible within a proper framework for appointing their own auditors, there are value-for-money and cost benefits in some degree of collective purchase. There is a question of collective purchase.

**Q299 Chair:** I want to pursue that, because Valerie’s point is very important. We should perhaps ask Peter Smith. What improvements do you see in the Monitor framework that will ensure that proper accountability protocols are in place so that another Mid-Staffordshire does not emerge? What needs to change? What would you build into the Local Audit Bill?

**Professor Smith:** One of the issues, which is not the fault of Monitor, is the current regulator set-up, with the split between CQC and the financial audit. I recognise that the role of the CQC requires different people to the role of a business regulator such as Monitor. However, in the end, the two have to come together, and I would really like to see some mechanism for integrating the judgments on quality and the judgments on value for money. Indeed, when health first went to the Audit Commission, that was done there. That really needs exploring quite hard, and I can say that the compliance regime that is operated now by Monitor is infinitely better than anything that preceded it. The extent to which we have to report detailed information—not just on finances, but on quality assurance—is much more rigorous than it ever was previously. Of course, the same requirements do not apply to non-Foundation Trusts, and many such trusts will find it quite challenging when they have to operate within the Monitor compliance regime.

**Q299 Valerie Vaz:** I am not saying that the audit fees that we now pay are about half of what we used to pay when we were effectively given our auditors—either the Audit Commission directly or a private company that had been delegated. The big difference is that we can now competitively tender for our external audit in a way that we could not previously. I believe that we now get a much better quality of audit. My third point is that I expect our external auditors to look at not only our finances but all aspects of performance in the trust. In particular, I expect them to look at our quality accounts. Indeed, they did so last year, and they chose two things and we asked our governors to choose another area where we wanted them to look into our quality accounts in more detail. As a consequence of that, we exposed further information and improved the quality assurance that we could make back to Monitor. Therefore would not want the Committee to think that the external auditors just look at money. Broadening their remit to look at quality issues is an extremely important part of their role.

**Q300 Heather Wheeler:** I find that answer really interesting, because I am interested in where the drawbacks are in being able to appoint your own auditors. This is now cascading down to all of the other health bodies out there, and you have chosen to extend the auditor’s remit to value for money and best-practice in-depth reports, whereas other foundation hospital trusts that I am aware of use alternative accountable critics or consultants or whoever to do a one-off project that might cost huge amounts of money, but keeps it separate. You, however, have chosen to do the one thing. What we are looking for is to strengthen the Bill or to show areas of best practice that ought to be encouraged for the other parts of the health service that are going to be able to appoint their own auditors now.

**Sir Robert Naylor:** It is really a question of finding the best people to do the particular job. If we needed to have an in-depth investigation into something, we may well go to someone other than our external auditors to do that, but our external auditors can also do a very good job. The key issue in appointing your own auditors is having a clear separation of the governors, the non-executive directors, who are accountable to the governors, and the executive. For example, it would be entirely inappropriate for me to be involved in the appointment of the auditors. They have to be appointed by the governors, and one of the non-executive directors is appointed by the governors to be the chairman of the audit committee. There must be separation between those who are accountable—the governors—and those who are the accountable officers, who are responsible for making sure—

**Q302 Chair:** And are those your local arrangements, or are they Monitor’s arrangements?

**Dr Bennett:** That split happens across the whole sector. That is one of the points I wanted to make. If
I just go back to the Mid Staffs situation and Peter’s comment about the split between Monitor and the Care Quality Commission. In those days it was not the CQC, of course—at the height of the problems it was the Healthcare Commission—and clearly there was a real problem in that relationship, which I hope is now fixed. Clearly the CQC is a different body to the HCC, and I hope that Monitor has also learned lessons from that.

Mid-Staffs was not a problem with audit. It was a problem with those who regulate quality failing to spot problems, and we were part of that. I recognise that and, as I say, I hope we have learned lessons. One of the lessons we learned was the need for us to pay much more attention to the quality issue, and we did at least a couple of things. One was we required foundation trusts to produce quality accounts. That is now required across all providers, but it was started between Monitor and the foundation trusts. The second thing is that we now look very explicitly at the issue of quality governance. Robert just explained that the auditors will look at things like the quality accounts when they do the audits, so it is more than just finances. We require that; we have written that into the audit code for foundation trusts precisely because we realised that there was a gap here, and not only was there a gap in requiring trusts to produce quality accounts and to look at their quality governance, but we needed to make sure they were doing it well. We then asked the auditors to review what they were doing as part of the audit process. That is a change that actually has come out of—

Q303 Chair: But I can think of one or two chief execs of NHS trusts—maybe not FTs yet—who would, if there was a critical report, manipulate the system to try to get rid of the auditors.

Dr Bennett: I suppose there is always the possibility of trying to do that. This is where one would hope the local governance arrangements—the governors and the non-executive directors on the board—would spot what was going on.

Q304 Valerie Vaz: Mr Douglas, you said that the NHS commissioning board would not be looking at quality issues at CCGs didn’t you?

Richard Douglas: No, I didn’t say they wouldn’t deal with quality.

Q305 Valerie Vaz: You didn’t mention the word quality in the list of things they would be looking at.

Richard Douglas: What I was talking about was what the external audit arrangements would be. The commissioning board itself would be absolutely focused on quality. The main business they are in is getting the best quality possible from the amount of the money that we give them. That is different from the audit arrangements they would have in place.

Q306 Valerie Vaz: Can I quickly give you a scenario? You have the clinical commissioning board, and they can get independent providers and private providers. What happens if you get, for example, something like a Southern Cross situation, where they fall apart? Who carries the buck for that?

Richard Douglas: In any circumstance where there is a reliance on a particular provider, the commissioning board will have to put in place alternative arrangements if necessary. We have—and this applies similarly across foundation trusts—mechanisms in place to ensure that you have continuity of service across the system. So we will have to have in place alternative providers. I could not see a situation in the foreseeable future where there would be a significant private sector providers commissioning board that would be in the same sort of position that Southern Cross was.

Q307 Valerie Vaz: But presumably their auditors will have sent a certificate. I am going into company law. An auditor looks at the books and says whether it is satisfactory. Presumably, that must have happened with Southern Cross and with the independent companies. It has to fall apart first before the regime steps in.

Richard Douglas: The auditors would have to declare if they thought the organisation was not a going concern. As part of their audit opinion, they would have to say if they thought the organisation was not a going concern because they would have to value it on a different basis. We would also look at the particular role that David has for the foundation trust, the regulator, to have an eye to that as well. You would not just rely on audit opinion for that.

Dr Bennett: There are limitations to what audit can achieve. Even in the case of PIRs, we can see that. As for two of the recent PIRs on NHS trusts, one was your own trust when I think it had been in deficit for five years at the point at which the PIR was issued. So that is a little bit late. We would aim to try to spot it earlier. The same happened in South London when they were actually in special administration at the point at which a PIR was issued. It is not clear that audit is the answer.

Q308 Valerie Vaz: That is exactly what we are saying. A regime existed with the Audit Commission when you could look at that. But we are worried, as a Committee and because this is public money, that audit is not the answer, but that is where we seem to be heading.

Dr Bennett: What I would argue was missing, and this is more or less what Richard was saying as well, was that, for those NHS trusts, there was not the equivalent of Monitor doing what Robert has just described in terms of looking at all of these things in great detail on a quarterly basis and trying to spot problems well before they become serious.

Q309 Mr Betts: On the appointment of the auditor, what you were saying about having oversight or an overview of what happens is interesting, and last week we talked about the absence of that in local govt. Just to come back to the point that Douglas made when he talked of the benefits to the organisation of independently appointing its own auditor, I haven’t heard a single benefit mentioned yet.

Richard Douglas: Appointing your own auditor does give the organisation itself a real corporate stake in the assurance around its own work. It is not that it is
Q310 Mr Betts: It is anyway, surely.

Richard Douglas: The relationship with the auditors is an important relationship and, for the board to feel that they own that is a lot of benefit.

Q311 Mr Betts: It is important once the auditor is doing the job, which is different from actually who appoints the auditor in the first place, isn’t it?

Richard Douglas: Well, partly, but in the appointment you will need to look at what is the best fit for that organisation in its particular circumstances. I agree entirely with Robert. You don’t want the executive team doing that. You want that to be the non-executive.

Q312 Mr Betts: But they do that, don’t they? They have a big input and a say. That the Government could have a serious input into this is fiction, isn’t it?

Sir Robert Naylor: As I said, from my experience I would absolutely keep myself entirely separate from the appointment of the auditors. That is a matter for the audit committee. As I said earlier, I am not a member of the audit committee, which again is an important discipline. If the audit committee is concerned about anything, it would call me.

Q313 Mr Betts: Is it a requirement that you aren’t a member of the audit committee?

Sir Robert Naylor: It is part of the code of practice.

Q314 Chair: Are members of your staff members?

Is your director of finance a member of a member of the audit committee?

Sir Robert Naylor: No, he wouldn’t be. No.

Q315 Mr Betts: But non-executive members of the board clearly are. You have a working relationship with them.

Sir Robert Naylor: I effectively work for them. They represent the governors and they are effectively my employer and my boss. At the end of the day, I do what they tell me.

Q316 Mr Betts: What would be the disadvantage if someone said, “There are only a limited number of firms that can do this work. These are your auditors for the next five years”? You would then develop that relationship on a proper working basis with them that Mr Douglas has just described. Why is it necessary for you or your audit committee to appoint the auditors for you to have a good working relationship with them?

Sir Robert Naylor: I can think of two reasons. One is to build on what Richard was saying, which is local accountability.

Q317 Mr Betts: To whom?

Sir Robert Naylor: Through the governors to the public whom we serve.

Q318 Mr Bacon: So you are already dependent on the vigour of the local newspapers. Is that what you are saying in that instance?

Sir Robert Naylor: Yes, to some degree.

Q319 Mr Bacon: What about your second reason?

Sir Robert Naylor: The second reason is purely financial. We get much better value from our auditors—as I say, about half the price going through competitive tender than we originally paid when the Audit Commission—

Q320 Mr Betts: We heard from local government people earlier that authorities such as Birmingham might be able to get as good, or even a better deal than they thought by doing their own, individual procurement, but many smaller local authorities felt the evidence probably was that they would need to combine together in some form or have some sort of national recruitment in order to get as good a deal. Is that true of the health service?

Chair: Most of the trusts are over £300 million, are they not?

Mr Betts: There would be a lot of kudos for an auditor to audit your trust, because of your reputation.

Sir Robert Naylor: The majority of foundation trusts are large enough to do their own procurement.

Q321 Chair: Are they mostly over £300 million?

Dr Bennett: It is a broader spectrum than that. That is probably around the average. Some are down in the region of £100 million to £150 million, and one or two that are very small are less than that.

Richard Douglas: For most foundation trusts, you would expect them to be in the position that Robert said. There will be some at the lower end where there may well be benefits, in terms of procurement, in going jointly to a provider.

Q322 Mr Bacon: It is interesting, because from what you have said, Sir Robert, you have a better service from your auditors for a lower price. What do you think was the principal cause—or causes—of the higher price and the poorer service beforehand? Was it an indifference, as it were, on the part of those who were procuring for a whole range of different hospitals, so they were handing it down Soviet-style, saying “Here is your auditor”, without any attention to the quality or the price? I caricature that, obviously, but what were the underlying causes of it being more expensive and poorer quality beforehand, and now, cheaper and higher quality?

Sir Robert Naylor: It was simply the lack of competition. When we go out to procurement now for auditors, price is obviously a consideration, as is quality. So, there is competition between the various audit firms, whereas previously there was not. They were simply nominated and told which audit company we were going to have for the following three to five years.

Q323 Mr Bacon: What do you think about the draft Bill’s proposals on whistleblowers? Are they strong enough?
Chair: It is probably best to let David Bennett start on that, then Peter Smith can come in.

Dr Bennett: To be honest, I am not sure I have a strong view about whistleblowing. I think that the view of my staff would be that, broadly speaking, it is not clear that whistleblowing through the audit route works terribly well. Whether you are talking about FTs or outside the health sector, it is just an issue.

Chair: We find it absolutely invaluable in our work. I have been astounded by how valuable it is.

Q324 Mr Bacon: Why is it not valuable, Dr Bennett?
Is it because, in the traditional way of such things, whistleblowers get screwed over by the system and they are not protected?

Dr Bennett: I suppose we are simply reflecting the view of my staff would be that, broadly speaking, it is not clear that whistleblowing through the audit route works terribly well. Whether you are talking about FTs or outside the health sector, it is just an issue.

Dr Bennett: The point is, we need to require these whistleblowers get screwed over by the system and they are not protected?

Chair: We find it absolutely invaluable in our work. I have been astounded by how valuable it is.

Q325 Mr Bacon: Is the quality of what you get coming directly to you high?

Dr Bennett: It is mixed, of course. Whistleblowing is always a very wide range.

Q326 Mr Bacon: Would you regard it as valuable?

Dr Bennett: Some of it is valuable and important.

Q327 Chair: And you, Peter Smith?

Professor Smith: I do not have any particular view on whistleblowing. It seems to me that it is not given enough seriousness in the Bill, but I have no particular view on how it should be strengthened.

Q328 Mr Betts: On the issue of comparability, from Monitor’s point of view, you have explained to us some of what you have been doing to try and get the financial information and draw those comparatives. Are we going to have similar arrangements as far as the commissioning side is concerned?

Richard Douglas: Yes, the commissioning boards themselves are very keen to make sure that we put in the public domain comparative information about the performance of clinical commissioning groups across the full range of performance on quality and on finance. So, we would expect to see, if anything, an even greater range of comparative data—a lot more than there is now.

Q329 Mr Betts: These are not going to be nice, little cosy arrangements with the various commissioning groups around the country to not explore the really difficult issues and challenge them.

Richard Douglas: No, they are not.

Q330 Mr Betts: We talked at the beginning about the potential differences—thinking about who drew the audit code up—between the foundation trust side and the commissioning side of the health service. Wouldn’t it be beneficial to have the same audit arrangements right through the national health service?

Richard Douglas: Shall I start off on that, David? I think as far as possible that is broadly the position we are trying to get to, where you have the single audit code of practice, you have a single arrangement for quality assurance and regulation, and you have a single arrangement for the scope of audit. I think there are differences, though, in the intermediate part of the system, between the role of a regulator like Monitor and the Commissioning Board, in relation to CCGs that passes public money through itself to go to the clinical commissioning group. So in a sense you need to have a slightly tighter arrangement around the commissioning side.

The basic principles we keep the same, but the flow of public money and the allocation through the commissioning places the Commissioning Board in a different place.

Q331 Mr Betts: That slightly implies you could have a laxer arrangement for Monitor, then.

Richard Douglas: It is not a laxer arrangement; it is a different arrangement. [Interruption.] I am not meaning to imply that it is laxer.

Q332 Chair: You are not saying that David Nicholson is going to run it in a really Stalinist way, therefore he does not need all the—

Richard Douglas: I come back to where David started on this. It is not just the audit arrangements that provide us with assurance. It is the way the management system works and the Commissioning Board as well.

Q333 Mr Bacon: Are you the Khrushchev of this new architecture, Dr Bennett?

Dr Bennett: I think we should withdraw the word “tightly”.

I agree with Richard that details of the audit do need to look different for different types of bodies, so that we must have as much commonality as possible. At the moment, we set the audit code book and make sure that we get agreement from the Treasury, the Department and the NAO as we do that, I think that in any future arrangement, as long as we are still setting the audit code, we need to make sure there is as much commonality as possible.

As I was explaining a moment ago, there is a connection between what we are doing in our compliance function and audit and, in particular, what we can do is use the audit activities to test the reliability of the data we rely on for our compliance. For example, our innovation around introducing quality accounts and quality governance, which we did through compliance, we were able to reinforce by having it audited under the audit code.

Q334 Mr Betts: That is the way you use information, rather than the differences in the audit arrangements, per se, isn’t it?

Dr Bennett: The point is, we need to require these things to be audited and that is what the audit code says. It gives instructions to the auditors. If we were not able to say—
Q335 Mr Betts: Would that not be helpful, though, for people on the commissioning side to have exactly that set of information?

Dr Bennett: Except, because commissioners and providers look different, the details will be a bit different. So I think, in principle, yes, but in detail, some differences.

Q336 Mark Pawsey: Have those of you who have had powers for some time to appoint your auditor any advice for local authorities that now have those powers under the Bill?

Sir Robert Naylor: I have thought about this. In fact, we had a conversation with a number of my senior people yesterday to ask exactly that testing question. The structure of foundation trusts is obviously different to the structure of local authorities. It is exploring the differences in the structures and accountabilities that is key. The one key difference between foundation trusts and local authorities is that local authorities do not have non-executive directors. The non-executive director layer between the governors—

Q337 Chair: I think they would say their councillors are, you see. That is the difference that we are—

Q338 Mark Pawsey: Some local authorities are enthusiastic about this new power. I know others have great reservations. Can you reassure those with reservations?

Sir Robert Naylor: We equated the elected councillors to the elected governors, with all the caveats about a number of people who vote for Governors. From a democratic point of view, they are comparable, but beneath that there is no non-executive director layer as there is in foundation trusts. Therefore, if you are going to have an audit committee, where does the chairman of your audit committee come from? So that was the key difference that we could discern. I am not sure that I could help any more—

Q339 Chair: Which leads us towards some thinking we were doing earlier about independent chairs of the audit committee.

Sir Robert Naylor: Exactly.

Q340 Chair: Right. That is very helpful.

Q341 Valerie Vaz: You mentioned you are pleased about the competitive tendering process. How much does that cost?

Sir Robert Naylor: It costs us very little in relation to the audit fee for the period in question. Our current basic audit fee is £150,000 a year.

Q342 Chair: What is your turnover?

Sir Robert Naylor: Just under £800 million. It is very cost-effective. Again, in preparation for today, we did some comparisons with non-foundation trusts. Interestingly, we found that—I am not prepared to mention which particular non-foundation trust, but it certainly wasn’t yours. Chair—their audit fees, appointed by the Audit Commission, were in excess of three times higher than ours. So there are significant differences. The cost of actually going through a procurement process is relatively little. It is the internal preparation of a specification inviting the companies to tender and going through the process. It is effectively lost in the time of employees and non-executive directors and governors within the trust. Clearly it does have a cost, but it is insignificant in relation to the five-year cost of the audit itself.

Q343 Valerie Vaz: I would just say about the extra fees that sometimes people think it is public money, so they charge extra when no one is watching them, but there is scope to reduce fees when it is in the public domain. I am not sure I agree with you entirely that there is no scope. You must be using some money for this process of competitive tendering, because that happens all the time. In terms of freedom of information, the regime does not kick in while you are undergoing this process, because presumably it is a private contractual arrangement. Is that right?

Sir Robert Naylor: I think we would have to examine carefully exactly what the question under the FOI was. If it was commercially in confidence, it could be excluded. Again, I have to say, to build on what I said earlier, I think it is extremely important that public bodies like mine are very open. We do our utmost to reply to all FOIs, so unless there was a real commercial conflict of interest, I am pretty sure that we would respond to the FOI request.

Richard Douglas: I should add, on the audit fee itself, it has to be declared separately in the accounts anyway, so there is specific provision that the audit fee has to be shown separately.

Q344 Chair: We are coming to an end. We need your stuff, Mr Douglas, and we might call you back. Mr Nicholson might make himself available next time. Beyond waiting for that, is there anything that would help us now as we prepare to tell the Government about the gaps and changes?

Professor Smith: Can I just underline how complex clinical commissioning groups are as enterprises? They are a creation that is qualitatively different from almost anything else in the economy. The deliverers of care are also deeply embedded in the running of the organisation. Huge amounts of public money are often delegated, sometimes even to the same people who are charged with governing the institution. That is a particularly sensitive area for audit. I think conventional models may not work and there may have to be additional safeguards built in.

Q345 Chair: Safeguards on independence, accountability and consistency?

Professor Smith: Absolutely. I would urge that those who are designing that scheme should take that fully into account. These are very unusual institutions.

Q346 Mr Bacon: Given that the NHS is increasingly buying in a whole variety of services from the private sector, do you see a risk that some clinical commissioning groups that are GP-led will end up buying services from entities that GPs themselves have a commercial interest in, and that there will be,
as it were, a skewing of public resources towards bodies that provide those services where GPs have an extra financial benefit?  

Professor Smith: The codes of practice within CCGs will have to ensure that safeguards are built in to ensure that those conflicts of interest do not arise. Part of the intention of the new arrangements is that new ways of dealing with health care will emerge from this. That will necessarily sometimes involve purchasing services from groups of GPs, so the important thing there will be that the correct governance arrangements are put in place to ensure that those who are involved in the purchasing—

Q347 Chair: And who will inspect those?  
Richard Douglas: There is a mix of things here. Anything that is to do with the commissioning of primary care services themselves will be done by the commissioning boards, not the clinical commissioning groups, so primary care commissioning comes up to the commissioning boards. There is no potential for conflict there. For the clinical commissioning groups, where they buy in areas that are not primary care, they are subject to their internal governance, oversight by the commissioning board and, in a market sense, oversight by Monitor as well. The provider market has to operate fairly. There has to be fair pricing and fair purchasing across that part of the market.

Q348 Mr Bacon: Dr Bennett, Mr Douglas has just told you that you will be involved in this. Can you explain how?  
Dr Bennett: He is right. The Government are going to be setting regulations. There are regulations, for example, governing what commissioners should be doing and how they should be doing it. We will be overseeing the application of those regulations.

Q349 Chair: If a commissioning group purchases from itself, will you detect that?  
Dr Bennett: If there are issues about that being done inappropriately, then we can look at it.

Q350 Mr Bacon: You mean so long as it buys from itself appropriately, then it is not a problem.  
Dr Bennett: There is not an absolute ban from buying from themselves.

Q351 Mr Bacon: Professor Smith wanted to say something.  
Professor Smith: I am currently a member of the NHS Co-operation and Competition Panel which will soon be integrated into Monitor.

Q352 Mr Bacon: You didn’t get the latest memo.  
Professor Smith: And that body is able to accept any complaints about breaches of proper market principles, proper procurement, unfair operation of the market and so on. We will investigate these and come to a judgment.

Q353 Meg Hillier: How will people know? If I am a patient and I go in and I get my big toe dealt with or my child gets their cough sorted out or whatever, I will be happy if I go away and that is sorted. Most patients will not dig through exactly how their CCG is spending the money. Mine in Hackney is full of really good people at the moment, while they stay on and do this job, but in time bad people could abuse the system. I am not clear how they couldn’t.  
Professor Smith: This is exactly why you need a regulator rather than allow the market to operate. The regulator can act on behalf of patients.

Q354 Meg Hillier: How would the regulator know? The CCGs are quite small. If you take my borough of 270,000 people, it is just one London borough. You have 33 in London alone. I think the viability will shake down. You are talking about hundreds of bodies whereas before you had PCTs which had their pitfalls, but were easily identifiable. They had enough people in them to have a bit of self-checking in there. At a doctors’ surgery you can have GPs employing other family members to do the other jobs and you could have an entirely family-run GP practice. There is nothing against that in the law or in practice. It is perhaps not best practice but it happens. If you had a couple of big practices like that in an area, having dominance in the CCG, you can see how there is scope for bad people to do bad things. I cannot see what protection there is against that.  
Dr Bennett: I don’t think patients will complain about this; it will be other providers, other GPs or people who want to compete with those GPs and feel that they are not getting an opportunity to do so because of this self-supply issue. That is where the complaints will come from.

Q355 Chair: Not really because if you want to get in there and get the business, you don’t want to upset your purchaser.  
Dr Bennett: Peter will tell you that they get complaints from providers about the behaviour of PCTs which are not, in their view, giving them a fair crack of the whip. I have no reason to suppose that that will stop.

Professor Smith: I do think there is scope for increasing the ability of citizens, competitors and other practitioners to raise these issues, and to raise them possibly on an escalating scale of intensity.

Q356 Mr Bacon: Do you think that is not clearly enough defined yet? You mentioned that the body that you are currently on, which is going to integrate—to use your word—with Monitor will do some of this work, but do you think that it is inadequately set out, that the guidance is too weak or that it could be stronger? What is it precisely that you are saying needs doing?  
Professor Smith: My own view is that the process works fairly well at the moment. I think someone raised the issue of providers being inhibited from referring because they want business elsewhere, and I think that that is an issue that needs to be addressed and it may, for example, be linked to the whistleblowing concern mentioned earlier. But we get complaints from a wide variety of people, with a wide variety of professionalism in those complaints. Some of them are just howls of anguish, others are legally
backed submissions. I think we ought to be able to accept all those types—

Q357 Mr Betts: Will it be a requirement on auditors to check systematically to ensure that there is no conflict of interest in the awarding of contracts of this kind?

Richard Douglas: They would have to check that as part of their overall checks on the control systems within an organisation. Whether they would actually have to work through every single—

Q358 Mr Betts: Would it be a good idea to be more specific in the requirements on auditors that they should be doing this as a matter of course?

Richard Douglas: It is built into the nature of audit that if someone was procuring inappropriately or unlawfully the audit should be designed to identify that if it was significant. I think that just in the nature of audit you would expect auditors to be focused on those areas of risk.

Chair: That was a very useful exchange of views, and we look forward to your paper setting it out. Thank you very much, but I know you have all given up valuable time. We are very grateful to you.
Tuesday 20 November 2012

Members present:
Margaret Hodge (Chair)
Mr Richard Bacon
Mr Clive Betts
Meg Hillier

Ian Swales
Heather Wheeler

Examination of Witnesses

Witnesses: Gillian Fawcett, Head of Public Sector, ACCA, Steve Freer, Chief Executive, CIPFA, Paul George, Executive Director, FRC, and Vernon Soare, Executive Director, ICAEW gave evidence.

Q359 Chair: Welcome, and thank you very much for agreeing to help us in considering the draft legislation. I thank Gillian Fawcett particularly, who is also an adviser to us; I think we have worked out that you are a gamekeeper turned poacher today. Steve, you are from CIPFA. Vernon is from ICAEW, and Paul is from the FRC.

Our task is not to say, “Was it a right or wrong decision”; it is to look at the legislation and really identify where we think there are flaws or gaps. That is the kernel of our purpose. I will start with a general question. I think some of us know some of Gillian’s views, so I will start with you, Paul, with your FRC hat on. What, for you, look to be potential benefits in the legislation, and the dangers and gaps?

Paul George: I would like first to focus on the benefits because clearly, that is always a positive way to start.

A lot of effort has been put into trying to replicate, where appropriate, the regulatory environment for private sector auditing, which has been in place for a number of years and has been working, by and large, reasonably well, so that is a good starting point. Like the legislation for private sector auditing, the Bill is quite complicated and there are lots of details that need to be filled in through subsequent regulations. Clearly, the art to making the Bill itself effective is to get the regulations as clear as possible, so those—

Q360 Chair: And where are the key regulations, for you? I like to see as much as possible on the face of the Bill.

Paul George: From the FRC’s perspective, there are some things around the definition of major audit, for example, because that will define respective responsibilities between the FRC and some of the other professional bodies that may put themselves forward to supervise public sector auditing. There are some details around the qualifications from bodies that—

Q361 Chair: I am not an auditor, so explain that first point to me.

Paul George: The intention underlying the Bill, as I understand it, is that there will be monitoring of the quality of audit work being performed. Some of that work will be performed by a professional body—for example, Vernon’s organisation, the ICAEW—and some directly by somebody more independent of the profession, such as the Financial Reporting Council. The split between what work is done by the professional body and what is done by the FRC, as the independent regulator, is struck on the definition of what is a major local public audit. Therefore, there is some work to be done to make sure we get that definition right, so the Bill can work in a proportionate manner. So that is one area.

Q362 Chair: So would you like to see that on the face of the Bill?

Paul George: I am not sure I would necessarily say that it needs to be on the face of the Bill. What there needs to be is absolute clarity, so that those who have to implement the legislation can do it as effectively as possible—as long as it is clear. It is not on the face of the Bill for private sector auditing. The FRC has designated what are major audits in the past, and that has worked reasonably well.

A number of other things in the detail need to come out. I have mentioned qualifications, and another area might be the resignation process. There are some provisions around what actions need to be taken and whether the Secretary of State can set further regulations, which is quite an important set of provisions that need to be developed.

The other area that I would highlight—again, there is a lot of overlap with what is happening in private sector auditing—is that there are a lot of different bodies that will be involved in making sure that this is all effective. I have no reason whatsoever to believe that each of those bodies will not operate effectively together, making sure that there are no gaps or overlaps. It takes a lot of working through, and we need to make sure that that happens—again, a number of the people in front of you are responsible for making sure that that happens—but it makes it complicated, to be effective.

Q363 Chair: For the local authority. Have you got the resources in the FRC to take on the new duties?

Paul George: Yes, we do. We may need to top those resources up slightly, but we have already been doing a lot of the work that is envisaged within the Bill. We have already been monitoring some of the work from the Audit Commission under contract, so we have a perspective on the work that it has been doing in-house for audit, and we also have a perspective on the firms—appointed by the Audit Commission—that have been undertaking audits. So we have some experience of doing that.

Q364 Chair: What about all the health bodies and all that sort of stuff? Have you had any experience there
of monitoring those audits, because it is a much more dispersed landscape?

**Paul George:** We do not inspect audits of foundation trusts to date.

**Q365 Chair:** We are concerned that there has never been a report in the public interest on any foundation trust to date.

**Paul George:** There are obviously some specific grievances around public interest reporting. In the terms of monitoring the quality of the audit of the health trust, so long as the requirements that the auditor is to follow are clear, then whether we are inspecting the quality of the audit of a health trust, a local authority, a major oil company or perhaps a retailer, the actual auditing standards are relatively consistent.

Clearly, there are some additional things that are particularly relevant to local audit—for example, value for money work—and we do have experience of looking at the Audit Commission’s work in that area as well. I am relatively comfortable that we have the in-house expertise. We will probably need to top that up slightly in order to undertake that work.

**Q366 Chair:** Let me come back on two things. First, the NAO is going to do the VFM stuff, so I do not know quite what you see your role in that as being, except to make sure that the framework is appropriate to enable that to happen. Secondly, you are the organisation—correct me if I, in my ignorance, have got this wrong—that is responsible for the quality of audit across the piece. If I were in your shoes and there had not been a report in the public interest on any health bodies, even though we know, because Monitor tells us so, that—I cannot remember the figure—20 or something like that are in financial difficulties, that would ring bells. It is a bit worrying that that part of your current responsibility has not triggered any activity from you.

**Paul George:** I will answer the first question first and then come back to the second question. On the first question—the respective responsibilities between the NAO and the FRC or one of the supervisory bodies—it is my understanding that the National Audit Office will be responsible for setting the standards, but it will be the audit regulators that will be responsible for establishing compliance with those standards.

In terms of your second question, I am well aware of your concerns, particularly from reading the transcripts of previous evidence about public interest reports. That has not been the scope of our work that we have been performing under contract for the Audit Commission to date. Certainly, I can see that being something that we would wish to focus in on, in terms of making sure that there were clear standards that the auditor was aware of and complied with in terms of when a public interest report should be produced and how such reports are produced.

**Q367 Chair:** Why has it not rung bells with you on foundation trusts to date?

**Paul George:** As I think I said earlier, we do not do any work with foundation trusts.

**Q368 Chair:** I do not know the answer to that. Does anybody know? Foundation trusts appoint their own auditors—can somebody help me on this?

**Vernon Soare:** I can say, Chair, that ICAEW carry out the review currently of the quality of audit work done on foundation trusts for Monitor.

**Chair:** For Monitor?

**Vernon Soare:** Yes, for Monitor under contract.

**Q369 Chair:** That is really interesting. So have you found anything? Here are all of us thinking that all these foundation trusts are likely to be in some financial difficulties, to put it mildly. Why has there not been a single report in the public interest?

**Vernon Soare:** In reviewing the work that the auditors have carried out, we have not seen any issues around the application of auditing standards, which is the remit of the work that we do in terms of monitoring the work that they carry out.

**Q370 Ian Swales:** What about issues such as going concern? Are you not asked to comment on such issues?

**Vernon Soare:** We look at the work that auditors have done around going concern, yes. Obviously, the definition of a going concern is that the organisation is financially viable 12 months from the date on which the audit opinion is signed.

**Q371 Ian Swales:** So you have never been in a position where you have looked at a health trust and said, “We think there is a problem within 12 months.” Is that what you are saying?

**Vernon Soare:** What I am saying is that when we have looked at the work the auditors have done, the view we have come to is that they did sufficient work at the time of the audit to satisfy themselves that the entity was a going concern.

**Q372 Ian Swales:** For 12 months. And it could fall off a cliff in the 13th month, and that would not trigger any—

**Vernon Soare:** Well, you can only look at what information the auditor had when they signed the balance sheet. So if there is a factor that comes in and no one was aware of it—

**Q373 Ian Swales:** I am not talking about new factors or post-balance sheet events; I am talking about what the auditors can, presumably, see on the day. Given what we are now hearing about some of these trusts, surely if these had been private sector organisations the auditors would have been blowing the whistle, wouldn’t they, in many cases?

**Vernon Soare:** The fact that an organisation is running a deficit does not necessarily mean that it is not a going concern.

**Q374 Ian Swales:** So is the Bill strong enough in that area? In terms of what we expect the auditors to comment on, do you think it is strong enough?

**Vernon Soare:** I can talk specifically, Chair, if you have finished with—
Q375 Chair: Gillian wanted to come in on that point, and then I will come to you specifically.

Gillian Fawcett: It is fair to say that deficits do not happen overnight, in most cases. There are early warning signals there, drawing on my experience. What you would expect to see is for a health trust to have financial plans in place, looking five years ahead, to get themselves out of that financial deficit. As far as I am aware, in most cases where there is a lead-up to a financial deficit, you would expect the auditor to be well aware of it and to work with the health trust to review the financial plan to see whether it stacks up and will help them move forward.

Q376 Ian Swales: This is really important. You are saying that, to the best of your belief, the auditors would have worked with each of the trusts in each case and said, “Okay, we have looked at your five-year plan and we think you are okay.” We have not had any reports to the contrary; that is the point. The reason why I am pressing this is because it is quite scary.

Chair: It ain’t like that—they haven’t got a plan to get out of their financial difficulties.

Ian Swales: Exactly. It is quite scary. If we are visiting this new system on to a new set of organisations, we need to know how bad it would have to be before the auditors would say something.

Gillian Fawcett: Yes. Drawing on my previous experience, there would be a three-way conversation with the Department of Health, with the health trust and with the auditor to make sure there were plans in place to move forward out of that deficit. I am quite surprised that an auditor would only look 12 months ahead.

Q377 Ian Swales: It is just that we are hearing so much about certain trusts that it is hard to believe that they have been passed by the auditors right up until recently. If you look at the state of them and what has had to be done—some of the London ones and so on; Margaret knows the names better than I do—it is hard to believe that the auditors have not said anything.

Chair: The other interesting thing is this. I know Steve wants to come in; maybe you can take this question, Steve, in your reply. In the new world, it looks rather iffy on the circumstances in which an auditor would do a report in the public interest, given what we know about what has happened so far with foundation trusts. Even more importantly, what would the mechanisms be for auditors to share information across local authorities, foundation trusts and academy schools so that one could begin to spot somewhere whether there are any systemic problems that would cause wider concern? How on earth will somewhere whether there are any systemic problems be for auditors to share information?

Chair: The other interesting thing is this. I know Steve wants to come in; maybe you can take this question, Steve, in your reply. In the new world, it looks rather iffy on the circumstances in which an auditor would do a report in the public interest, given what we know about what has happened so far with foundation trusts. Even more importantly, what would the mechanisms be for auditors to share information across local authorities, foundation trusts and academy schools so that one could begin to spot somewhere whether there are any systemic problems that would cause wider concern? How on earth will somewhere whether there are any systemic problems be for auditors to share information?

Q378 Ian Swales: You are making two really powerful points there; if we can just unpick them for a moment and go to back to the first one. You said you felt that on the scope issue—you used four expressions: regularity, propriety, probity and value for money—less work would be done in all those areas, or that there would be less ability to find things as a result of the Bill. The other point concerns the reporting mechanism. You were suggesting that it is less likely that things will be found in the new regime. Can you say a bit more about that?

Steve Freer: Over the past 20 or 30 years—the period in which the commission has been in operation—we have seen that the entry of firms into this market is quite difficult. That reflects the fact that the transition from private sector auditing, which firms are clearly extremely good at, to public audit is not straightforward; it is very challenging and difficult. The firms that have been relatively more successful in that market have found that, in order to do public audit, you need to develop specialist groups of staff who by and large do that as their full-time occupation.
They become specialists in those wider aspects of the audit regime that applies to the sector. The commission has been a very expert overseer of those arrangements and has been quick to criticise firms that have not been sufficiently well equipped to do those more specialised public sector tasks. Again, if that expert supervision disappears or is replaced by more general supervision—or by supervision that thinks that public and private audit is all much of a muchness—gradually, we will see, in a sense, a dumbing down of public auditing and, to an extent, a narrowing of its traditionally wide scope.

Q379 Chair: Before you go on to the second one, I want to give Mr George a chance to come back and comment on that, because that has huge implications. Paul George: Thank you. I certainly don’t think it’s going to lead to a dumbing down of—

Q380 Chair: Why not? What are you doing to make sure that that isn’t going to happen? Paul George: First, while Steve is absolutely correct—most of the firms undertaking this work do establish divisions and appoint people within those divisions who have the required skills to undertake that work—the Audit Commission has found, and we have found by reviewing the work, that, just as there are some benefits to private sector auditing in learning from the experience of auditing public bodies, the latter can learn from the skills and expertise of private sector auditing as well.

Q381 Chair: I don’t understand what that means—just explain that to me. I know it’s something that people have spat out quite often, but I am interested in what it actually means in practice. What are the skills that you can bring from the private sector that will improve and enhance public sector auditing? What further things are you going to do to ensure that those hugely important points that Steve Freer has brought into the debate are going to be protected—apart from saying, “I can do it”? Because otherwise, we will look to recommending a strengthening on the face of the Bill, rather than leaving this to regulation. Paul George: For example, historically, the focus of public sector auditing has been very much on the income statement—income and expenditure. While that is very important and links with some of Steve’s comments about probity and value for money, what it has meant is that on occasions the balance sheet has not had such a significant focus. Going concern is a major issue as far as private sector auditing is concerned, and therefore the skills and expertise that private sector auditors have at auditing the balance sheet, looking at the liabilities and—

Q382 Chair: That is why we are so astounded that no one has drawn to our attention the fact that up to 20 foundation trusts are in the red, with very little prospect of getting out of it. Paul George: Perhaps I can go back to my earlier comment, in that we do not monitor the audits of foundation trusts.

The other point that Steve mentioned concerned the expertise on the FRC board. We have a particular committee that supervises our work on audit monitoring, and it comprises one of Steve’s former presidents who has experience of working in the health sector. I am sure you are familiar with Sarah Hogg who chairs the FRC; she will have a responsibility to make sure—as in other organisations—that the board, in accordance with the combined code, has the requisite skills and resources to challenge the work that we are doing. That happens on an annual basis. The work of the FRC has evolved over a number of years. If we didn’t think we had sufficient expertise on the board, then clearly we can supplement that.

Q383 Mr Betts: How far does this draft legislation require you to change the way we do things, to take on board these public sector responsibilities; or is it something you are going to think about doing, and there is a permissive element to the legislation to allow you to do it if you think it relevant? Paul George: We have obviously been doing some thinking there. The Department came to us to ask if we would be prepared to take on some of these responsibilities. We didn’t seek to take them on—Chair: Can you answer the question? Paul George: I am just coming to the question. We have already been doing a lot of work with the Audit Commission, looking at a significant proportion of the work we would be asked to do if the Bill is enacted as proposed, which is around monitoring. We also have experience in overseen the work of the ICAEW, CIPFA and other professional bodies, which is another key factor that the draft Bill requires. The Bill requires the FRC to make sure that the professional bodies have adequate systems in place to ensure that only the right people are able to conduct audits. That is what we have been doing in the private sector. To extend that to make sure that those systems and procedures now adequately cover public sector auditing is not a significant change of tack. It does not bring completely different issues; it is an extension of the responsibility—

Q384 Mr Betts: That seems to be where we have a fundamental disagreement, do we not? Paul George: Yes, perhaps. I am not sure how much of a disagreement—

Q385 Chair: Are you going to build a bridge between the two of them? Vernon Soare: I will try to reconcile these two. Chair, I think it is important that you ask at the beginning what still needs to be tightened up in the Bill, or made clearer. The scope of the audit is very important, so I think there are elements of that scope—exactly what is meant by value-for-money work in the new regime as opposed to in the regime it is replacing. On whether it will be—to use Steve’s phrase—dumbed down, I don’t think so. One of the reasons is of course that the vast majority of people doing the audit work in the new regime will be the same people, by and large, who are doing it now. With the abolition of the in-house practice of the commission, as you know, its staff are going to the firms, and the firms that have been working on Audit Commission work
for many years now—probably 25 to 30 years—do have experts in-house, value-for-money people, etc. It is probably not an interest to declare, but 15 years ago I worked for the Audit Commission, and did quality assurance work with the firms as well as with the in-house practices, and they do have the right staff. The key point in this, as Paul referred to, is for the new regulatory regime, which currently sits with Audit Commission, to be robust enough to ensure that auditors are delivering on that scope. That is the important point.

Q386 Chair: So strengthen the scope. On the regulation, is there anything you need to change there?

Vernon Soare: The other issue that needs to be strengthened is that the Bill, as it stands, by and large with some further work, can work in what one might call “the normal circumstances”. This is where we come back to public interest reports. We are not quite so sure that, at the moment, it actually caters for extreme or difficult situations. Relatively frequently compared with the foundation trusts, public interest reports are issued in the local government sector.

The Bill currently does not have a mechanism for sorting out the point where an auditor believes that he or she needs to issue a public interest report and do a fair amount of work, and the local authority is going to have to foot the bill. Currently, the Audit Commission indemnifies. In the new system it is not clear, and although it could be said that the auditor could go to law, it is not a good use of public money going to law to get the fees back. That is an issue that we are a bit concerned about, and that it does not cater for those more extreme situations.

Q387 Mr Bacon: Do you have any concerns about the new responsibilities of the National Audit Office in relation to value for money? Do you think it has sufficient resources to carry out the value-for-money work?

Vernon Soare: In a sense, that is a question for the National Audit Office, but it is going to set the framework. It is going to be, as I understand it, asked to deliver studies in the sector. Interestingly, it has been delivering studies in the health sector for many years so, from a personal point of view, I believe that it would have the resources. I know that it has staffed up, bringing somebody in as a former finance director in the local authority. I assume that it would, but I am only speaking from observation.

Q388 Mr Bacon: Do you have any sense of the profile of value-for-money work from the Audit Commission, as it has developed over the years? One of the things we have heard quite recently is that, as it expanded and did more value-for-money work, the quality of the Audit Commission’s value-for-money work was not always of the highest order; in fact, it declined. Is that your own sense?

Vernon Soare: I have to say that I don’t really have the sense of that, not being in that sector.

Chair: Do you want to come back, Gillian?

Gillian Fawcett: Yes, on three points. In relation to resourcing and staffing for the National Audit Office, a real opportunity has been missed to transfer some of the skills and expertise from the Audit Commission across to the National Audit Office. That is quite a loss to the sector in terms of expertise.

Q389 Mr Bacon: Can you clarify that? Are you saying that there are lots of value-for-money people who have worked in the Audit Commission, whom you would have liked to have seen transferred to the National Audit Office?

Gillian Fawcett: Yes. I think that, if the transition had been much smoother, you would expect some of that expertise.

Q390 Chair: What has happened to them? Have they just gone?

Gillian Fawcett: Well, they have gone off in various ways. Lots are pursuing consultancy work and the like. There is a missed opportunity there.

Q391 Mr Bacon: To speak to my previous point, if the quality of the value-for-money work that was being done had palpably declined, and there is some evidence from commentators and people in local government that it had and that they were not impressed with what was coming out of the Audit Commission, why would the National Audit Office want those people?

Gillian Fawcett: A long history and knowledge of the sector in terms of bringing them into the fold and looking at new ways of developing the value-for-money programme. [Interrupts.]

Mr Bacon: Sorry, my mobile phone speaks at me. I have asked my office to find out how to stop it. I never consciously started it. It is one of those things that I didn’t start but I can’t stop. I interrupted you. You had finished your first point, but you had one or two more points to make.

Gillian Fawcett: I am not so sure whether the value-for-money studies declined or whether they were just superseded by what was a comprehensive performance assessment, and that the two became very muddled. In many ways, some people thought that it was either one or the other and not both. Things have moved on, and certainly in terms of looking back to the halcyon days of the Audit Commission and those big national studies that had a lot of value in terms of efficiency and effectiveness across local authorities and addressing some of the wicked issues, they were successful for a time. I just wonder whether the comprehensive performance assessment programmes were really superseded.

Q392 Mr Bacon: In so far as the National Audit Office enters into this area—its remit is to do a relatively small number of studies at least to start with, possibly a maximum of six—would you like those studies to be bigger and meatier, and what you call big national studies, big thematic studies looking at these issues across a range of different local authorities in the ways of the old halcyon days?

Gillian Fawcett: Absolutely. In terms of addressing some of the wicked issues, which are perhaps not prioritised or are priorities at a local level, where there is scalability in creating national efficiencies, I think that there is a place for that. The National Audit Office
should consult beyond the reference group that it currently has in terms of what those areas are and what the key issues are that need to be addressed.

Paul George: I was just going to add a little bit to what Gillian has said. Gillian has been focusing on the thematic studies, the cross-sector work, that has previously been done by the Audit Commission. There is another part of the value-for-money work, which is the specific opinion that an auditor will provide in respect of the particular local body that they have been auditing. One of the things that the National Audit Office will want to do is to look at whether those standards and the reports that are the product of those standards are adequate. At the moment, the opinion is very much couched in the terms of process, so it looks at, “Does the organisation that has been subject to the audit have the right processes in place in order to ensure that it is getting the right value for money in its products and services that it brings in?” One may wish to look at that to see whether it needs to be enhanced in any way.

Q393 Heather Wheeler: I am interested in this—the Bill is there and the Audit Commission has gone. There is a bit of a tail of work. There are still some existing contracts. Who will be responsible for overseeing those contracts, post 2015? Has that been sorted out?

Paul George: I do not believe that it has.

Q394 Heather Wheeler: Perhaps that needs to be stated somewhere.

Vernon Soare: The five-year plus contract that has been under the current regime. The issue of timing is that there will have to be an agreement—a cut-off point between when the Commission ceases doing the quality assurance work and when it passes to bodies such as ICAEW or others who may wish to enter into this sphere and the FRC. We are in discussion with the DCLG about where the cut-off will be. There should be no hiatus between the two.

Q395 Heather Wheeler: So does that need to be a statutory instrument, an advisory note or something in the Bill?

Vernon Soare: I could not advise on the exact mechanism, but yes, it needs to be done.

Q396 Ian Swales: May I move on to the question of independence and the proposals in the Bill for independent auditor panels? Can we hear what you feel about that? Clearly, it is important that the auditors are independent, but does the Bill adequately cover that?

Steve Freer: This is another area of significant difficulty. We go back to the principles of public audit with which you are familiar. Again, I know that they were mentioned in the Select Committee. The first one is about independence of public sector auditors from the organisations being audited. The legislation, as it currently stands, feels like a very awkward attempt to achieve that level of independence around the appointment within the new framework. I have yet to meet anyone who is enthusiastic about it. I apologise; I did read the evidence and I think that Birmingham city council seemed to be reasonably comfortable with it. The majority of public bodies do not feel that audit appointment panels are the appropriate way—

Q397 Ian Swales: So awkward in what way, and what better proposals are people coming up with?

Steve Freer: Awkward in the sense that there does not seem to be an enthusiasm for these panels from the audited bodies. I think there are significant concerns among those bodies about whether they will be able to attract people to serve on these groups. There are also potentially questions about whether, if we put all this in place, it will really be independent in an effective way.

Regarding alternative proposals, it depends on whether we are working within the constraint that the Audit Commission must be abolished.

Q398 Ian Swales: Let us start with that as an assumption. We are working on the basis that we have a Bill that will go through, and we are trying to make it better through this process.

Steve Freer: If that is the constraint, and there is no room for a residual national body to pick up some of these functions, the better bet would probably be for the role of audit committees within the public bodies concerned to be re-engineered to address this responsibility.

Q399 Ian Swales: Audit committees within the bodies might involve elected representatives, for example. Are you talking about the type of audit committees that exist in local authorities now? You would, say, have them appoint the auditors?

Steve Freer: Essentially I think it is about reviewing those committees. There probably is space for elected representatives. There is almost certainly a requirement for independent members to be in a majority and for independent chairs to be appointed.

Q400 Ian Swales: But you also feel that one proposal would be to retain some kind of body? We have had the joke in the Committee before that we might retain something, but we could not call it the Audit Commission. That is one live proposal.

Vernon Soare: This is only an issue in the local government sector. The health sector has been working with audit committees and independent audit committees for many years, particularly as their accounting and auditing arrangements are similar to those in the private sector.

The awkwardness in the local government sector—I say this from my days as a local government auditor and having worked in local authorities in the now dim and distant past—is that it cuts across the political environment. Let’s face it: elected members have a mandate, and an independent audit committee does not sit easily in that structure. That is the point.

The independent auditor panel could work. On the issue about finding the necessary people, I remember when audit committees were brought into the health sector, a lot of people said, “You would not find the people.” Actually, the people came forward. I am not saying that it is easy, but I think that could be overcome.
The potential problem of having an independent auditor panel and an audit committee, as well as a full council—I come back to this issue—is that it may work when everything is going fine, but when you get to the point where things are not going so well, you have the auditor, the independent auditor panel, the audit committee and the full council. I think it is too many, and I would agree with Steve that you should perhaps try to focus it on one committee or one panel, if that means putting the audit committee on a statutory basis, which it is not currently in local government, to reduce the kind of noise that could happen in those situations. You want only one focal point for the audit appointment and dealing with audit matters in the authority.

Q401 Ian Swales: I have two quick follow-up comments. You made one important point that I think we need to bear in mind as a Committee, which is whatever mechanisms we come up with, they need to be fire-proofed and tested against worst-case scenarios, and I think you have made that point in an interesting way.

The other point that strikes me is smaller bodies. We are not talking about just local authorities here. I am not sure that the proposals will work well for academies.

Q402 Heather Wheeler: I am just interested that you say that there is an independent audit committee for trust hospitals or whatever they are. Bearing in mind that we are talking about a locality, surely to goodness, why do we not give them twice the job? Why do we not get them, immediately then, to become the independent audit for the local council? Then it is job done, and you do not have to go through all this angst that everyone is going on about. Why do people not perhaps take that as a view, that they could go across that as well?

Paul George: I was just trying to check, but it was my recollection that there was provision that, if appropriate, the audit committee could take on the functions of the independent auditor appointment.

Vernon Soare: My point is about sharing across public bodies. In some senses, there is no reason why it could not be similar, or the same, people. Obviously there would be a legal, confidentiality issue around it, but I would suggest that the people with the skills, as you intimate, are likely to present themselves as audit committee members in any local government audit committee situation.

Q403 Heather Wheeler: You’ve got one hospital in one area; you’ve got one council in one area; you have an audit committee for the hospital; why can’t that audit committee do it for the council?

Chair: And for the schools?

Ian Swales: We have to test all of this at the boundary, don’t we? We have to test if this works for the smallest organisation we can think of.

Q404 Chair: Before I bring Clive in, may I just ask, do we need this national list of appointable auditors?

Gillian Fawcett: I am going to attempt to clarify this national list. It is all about governance and accountability at the departmental level—at the accounting officer level. The DCLG issues substantial amounts of money to local government. The accounting officer at the end of the year has to sign a governance statement that basically says that he is assured that there is sound financial management for that money spent, that there is value for money, that there are good internal controls and procedures in place. He or she has to have that assurance before they sign that statement. What the Audit Commission have produced, in the past, was a statement that would give that accounting officer the assurance that public money has been well spent. Within that statement, you would have information such as all local authorities that appointed their auditors; all local authorities that produced their financial accounts; most local authorities had a clean opinion, with no qualifications. Where authorities had significant qualifications, that information would go back to the centre.

Also, one of the big national initiatives for change in financial accounting across public services has been a change relating to financial reporting to IFRS. Now, that has to be driven and co-ordinated across all public bodies. So the information coming back to that accounting officer is telling him or her that that has been implemented, and has been implemented well, so that accounting officer can then sign the governance statement, or assurance statement, which will then lead to accountability to Parliament. It is not just about a list of who audits whom, or whatever; it is actually an important part of the governance arrangements for public money.

Chair: That is very helpful. Thank you.

Q405 Mr Betts: When Ministers first announced their intention to abolish the Audit Commission, and hadn’t quite got as far as thinking about what was going to replace it, it was going to save lots of public money. Is it your view that that is still the case?

Vernon Soare: There have been some savings realised, through, for example, the demise of the in-house audit practice and the final salary pension scheme. People have now gone to firms where they won’t be in that situation. The issue that has been uppermost in people’s minds is ongoing: will there be savings from audit fees? This is potentially what you are driving at here. From our point of view, though firms will obviously have their own point of view, the answer at the moment is that, actually, nobody knows, because this is going to be a new market. Up to this point, the Audit Commission have acted as somewhat of an economic regulator, and firms, in bidding for
work, have had to take fairly attractive audits and not so attractive audits, and have had them as a package. Under the new system, depending on how authorities and trusts decide to procure, firms will be able to decide whether they want to take a particular audit or not. Probably—and this is purely surmising—what you may find is significant competition for the very large, major audits that Paul referred to. They may get a benefit, as the fee may come down, as happens in the private sector. The issue is for the smaller bodies. On that analysis some of them might find their normal audit fee going up because the firms will have to take on audits that in the past they would have taken on as part of a package but are now taking on individually.

Paul George: I agree.

Q407 Chair: There is obviously a relationship between audit fee and outcomes. If the pressure is to push the audit fee down, what do you think that will mean in terms of quality? Is there a quality impact? Paul George, go on, this is for you.

Paul George: This has been something we have been concerned about in the private sector. There is quite a lot of pressure at the moment to result in considerable fee pressure. The role we play is a counter-balance to that. We are not an economic regulator but what we do is ensure that the auditor does not short-change in undertaking the work required. We look at things after the event and that provides some safeguard. Clearly there is a risk: if you drive prices down too low, you will not get the same quality of work.

Q408 Mr Betts: How will you stop that from happening?

Paul George: The only way we can stop that from happening is to hold the firms to account, either through reporting on the quality of their work or through the disciplinary arrangements, if the auditors do not do what they are required to do.

Q409 Mr Betts: Isn’t there a danger, going back to what Vernon just said, of smaller organisations probably having their fees pushed up? They are having their budgets squeezed. They are going to be suffering; they may see their fees starting to rise?

Paul George: As I said, the only way we can stop it is through the quality of our review work. As it happens, the review at the bottom end of the smaller authorities will not fall to the FRC, but the principle is the same. If there is a reasonable chance that you will be selected for inspection, so that somebody will assess whether you have done adequate audit work in comparison to the standards, that is a good incentive to ensure that you do not short-change in the work you do. It is a matter of judgment and it is very difficult, particularly when you are doing it on a sample basis and after the event.

Gillian Fawcett: On the small audits there is actually what they called a limited assurance audit that is carried out. The problem I can see with that is that they have applied the small companies’ threshold of €6.5 million, so any small organisation below that gets a limited assurance audit. That should help to limit the fees. The problem is that the European Parliament is apparently considering uplifting that threshold to €10 million, which would mean a substantial number of small councils falling below that threshold and receiving a limited assurance audit. Just to throw something into the mix. If you look at the number of public interest reports that come out, they tend to come from the small audits for small councils. If you looked at 2010–11, there are 68 public interest reports. You are basically squeezing it so much that you are not carrying out a wholly effective audit.

Q410 Mr Betts: So will we see the public interest reports go down because nobody is doing them?

Gillian Fawcett: Potentially.

Vernon Soare: Can I just say that the audit firms will be thinking very much about their professional and ethical obligations as well as their reputations? It is not inconceivable, for example, they put in a particular proposal for an audit fee, the small body says, “Well, we are going to pay you less.” They could say, “Well, we won’t do the audit work, then.” That is a scenario.

Q411 Chair: Who should be paying for this? How would you resolve this? You haven’t got the Audit Commission, you have got the new Bill, and you are going to have the new arrangements. Taking your point, Vernon, that we have to think about these exceptional situations, how do you resolve this? What is your answer to it all?

Vernon Soare: I think there is a provision in the draft Bill that, if an authority fails to appoint an auditor, the Secretary of State could order or appoint one. I do not think from the way I read it—I may have misread it—that it quite gets to the situation where no audit firm wishes to do the audit. At that point, I do not think the Bill has anything to say.

Paul George: I was just going to add one point. On the overall fee position, I think that what nobody can yet predict is whether the reduction in fees that is likely in the larger entities will more than compensate for the increase in fees. The problem with the cross-subsidisation of the market as a whole is that it will be a great challenge on the small authorities.

Q412 Ian Swales: On the theme of testing this against real cases, let us take the case of an academy school—I am not making this case up, by the way—that has a friendly auditor. Fairly significant fraud takes place inside the academy that is not picked up by the auditor; in the end, it is a whistleblower who raises the case. I am particularly struck by what Gillian said about the fact that the majority of public interest reports are actually in smaller bodies, not bigger ones; this would be an example. Under the new circumstances, how do you see the arrangements working in a case like that in terms of the appointment, the work required to deal with the situation and who would pay for it? Just walking...
through that will highlight some of the issues that we have been talking about. I do not know who would like to have a go at that, Steve?

**Steve Freer:** I can certainly start to walk through it. I think the auditor must have the freedom to pursue the line of investigation. There should not be any obstacles that can be put in the way of that. It seems to me that the auditor must have the right to be paid for the work that he or she needs to carry out, and it seems to me that there ought to be a straightforwardness about that leading to a public interest report. Again, there should not be fences that have to be jumped over to seek approval to publish.

Q413 Ian Swales: I think we touched on this briefly earlier, but let us just try to wrestle it to the ground. What about the issue of fees in a case like that? The auditor hits this issue. He or she has already agreed the audit fee and sees there is more work to do. As the Bill operates, am I right in saying that we would be expecting the audited body to pay these extra fees? Would there have to be a negotiation? That does not seem right, does it?

**Vernon Soare:** It is the auditor body, on the recommendation of the independent auditor panel, that would look at the circumstances. That is the way I understand it works.

Q414 Ian Swales: This is more a question for the Chair. Do we need to start thinking about some contingency fund or arrangements that apply in cases where the investigation, in the end, may be completely disproportionate to the organisation’s ability to pay?

**Chair:** We have talked in previous sessions about the Westminster case, which cost millions. Hopefully it is an exception, but nevertheless, without the backing of the Audit Commission to pick up the bill, would it ever have happened?

**Vernon Soare:** Pragmatically, some sort of provision held centrally for that issue may be the way forward. On the other hand, the dictates of localism may point in a different direction. You can see some electors in other areas saying, “Why have I been paying for what’s been going on over there?” But I think pragmatically, I am making a different point.

Q415 Heather Wheeler: We have really picked up on this issue of the whistleblower. It is very interesting to hear the example of the academy. Do you think that the Bill is strong enough in assisting whistleblowers? Particularly if it is now so obviously a private company doing the audit, would a whistleblower feel comfortable going to the auditors rather than straight to the Audit Commission or something like that? I put it out there as a question, not because I believe it.

**Steve Freer:** I think it is important that the whistleblowing arrangements are rewired into the new arrangements. Although whistleblowing to the auditor is not the only route, it is a very important route that needs to be kept open. I suspect that there may be some people who would be more comfortable phoning the Audit Commission than phoning a firm; there might be some the other way. It is important to reiterate that there are other routes available, but I repeat that I think it is very important to make sure that that one is securely woven into the overall arrangements.

**Chair:** Good. That was a very interesting session. I am grateful for your brains and for your thoughts on the issue. Hopefully, we can come up with a Report that improves on the proposals.

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**Examination of Witnesses**

**Witnesses:** Gareth Davies, Partner Mazars LLP, Sarah Howard, Head of Public Sector Assurance, Grant Thornton LLP and Paul Woolston, Assurance Partner, PwC gave evidence.

Q416 Chair: Welcome. Were you all present at the previous session? You were, so you know what we are about and what we are trying to establish. Clive has gone. Clive and I are old enough to remember pre-Audit Commission days in local government. I was a leader and I remember having regular meetings with my auditor during difficult times. It feels to me a little like a circle and that we are going back now to having auditors appointed by local authorities one way or another, however independent the audit body is in the end. I am interested to hear from you how, in that context, you are going to be able to retain true independence in the public interest and what powers you think you should have, or if you think you need any strengthening of what is in the legislation to ensure that.

A lot of us on this Committee come from the Public Accounts Committee. We assiduously follow the taxpayer’s pound, and we want to be able to do so in the new arrangements. We have some concerns that you may be sucked into the authorities that pay your bill; that you will not be able to do public interest reports, or you will be less likely to; and that the experience so far—I accept it is early days—of foundation trusts suggests a reticence to act in the taxpayer’s interest in the way that has happened under the Audit Commission. Who wants to start on that?

**Paul Woolston:** There are two questions: one about the independence and one about public interest reports. All our work is enshrined in being independent. If you lose that, you kind of lose everything, so our internal systems and our training mean that our people are trained to be sceptical about what they hear. They have to be independent. I do not really see it as being that much different in the new regime from how it is now, so we have to be independent.

Q417 Chair: Except that they employ you, in one way or another. Thinking of my own authority, which is 100% Labour, you can have whatever sort of audit committee you like, but I have seen it—

**Mr Bacon:** Strong leader there.
Chair: It is not me, thank God. This is Barking and Dagenham. It is 100% Labour, and when I look at their scrutiny arrangements, even I am extremely sceptical about how independent they currently are. I can see the leadership controlling the audit appointment. I do not think that that will sound so unusual to those of us sitting around the table.

Paul Woolston: I think we would have to be even more independent then. We would have to take that stand. On public interest reports, my view is that they are relatively blunt instruments, which quite often take a long time to produce. Earlier on you were asking about foundation trusts. As an auditor, you actually have a means there to deal with the issue promptly, through the audit committee, the board or the board of governors. Fortunately, I have not had any that are in that kind of difficulty, but the public interest reports that I have been involved with take an awful long time to produce and have been a bit too late. So I am not a big fan of public interest reporting for drawing attention to something and/or being able to deal with difficult situations. I would rather be able to deal in real time.

Sarah Howard: Independence is absolutely fundamental from a number of perspectives. It is crucial in terms of supporting local democracy and protecting councillors and officers, and it is critical in terms of giving assurance to local electors. Particularly in a period of decentralisation and localism, the independence of the auditor is paramount.

Q418 Chair: We all agree with that; I do not think that anyone would disagree that that is where we want to be. Our concern is that, in the new regime, rather than you being appointed and allocated work through the Audit Commission, which enshrines your independence and is a good way of doing so, you will be appointed in some way or another by the local authority. Under those new arrangements, how can you enshrine that absolutely essential independence that we all think is hugely important?

Sarah Howard: Absolutely. That is important from our perspective to being able to act totally independently, and also from the council’s perspective and the councillor’s perspective.

Q419 Chair: Okay, but how? How, how, how?

Sarah Howard: Our view is that that is best served by some form of procurement and appointments body, whether that is national or regional, with local authority—

Q420 Chair: So you would rather have a national body. I think one of our witnesses said last week that it could almost be a little residual body doing the appointments.

Sarah Howard: You referred to that earlier, and I think it is similar to the proposal for the local councils—the small bodies—that takes the concept of the auditor panel to its logical conclusion, which is for that to be efficient and effective, and potentially to deliver savings through national procurement. In effect, you would take that to a regional or national level. But it is critical to view this from the elector’s point of view and the councillor’s point of view, because it is fundamentally important for councillors to have that protection so that they are able to say “My auditor is completely independent.” Certainly in our experience that is what local electors want assurance over too.

Q421 Ian Swales: Can we just explore this once again at the boundaries? So, if something goes wrong, the electors kick out all the councillors. What happens to the auditors? What sanctions should we have? I am talking about something going seriously wrong, as we have seen in some private sector situations. What should happen, and what do you think the Bill says about sanctions? I am not suggesting that we need something to keep you honest, but I presume you understand why I am asking the question.

Sarah Howard: In relation to public interest—

Q422 Ian Swales: In the case where something goes seriously wrong, we have got people who are democratically accountable; we have got officers who, I suppose, have their careers on the line. What about the auditors—what should the sanctions be, and what should happen?

Gareth Davies: It could be that the auditor has detected the problem and brought it to light, and that is the trigger for the electorate taking control. Otherwise, it is a case of audit failure as well.

Q423 Ian Swales: That is my question. The first bit is the good story and the second bit is what the question was really about. Either because the auditors were too close or just because they had not done their work properly, they missed a lot.

Gareth Davies: The Bill provides the mechanism, using the FRC and the supervisory bodies that you have been hearing from. So in that situation, where there was a prima facie case of audit failure, I am sure that there would be an investigation—just as there would be in the private sector and just as the Audit Commission currently does in public sector audit—to get to the bottom of whether the auditor should have behaved differently.

Q424 Ian Swales: But are the new arrangements strong enough? I think it is in the interests of the profession that the new arrangements are strong enough to protect it.

Gareth Davies: That was the point that I was going to add to Paul’s and Sarah’s. Your earlier discussion with the previous witnesses about the difficult cases would be my answer to your question about whether this is an adequate protection of the independence of auditors. In 95% of all our audits, the kind of up-to-date conversations that Paul was describing are the way in which you resolve issues, and it works well. But it is in those hard cases where this is going to be tested. In that case, I do not think that the Bill adequately protects the position of the auditor.

Q425 Chair: So what would you put in?

Gareth Davies: You have already heard one point, which was the—

Chair: Independent appointment.
Gareth Davies: Well, essentially, I think there needs to be a choice now. Either we go for local appointment, in which case the audit committee of the body, suitably beefed-up, carries out that role, or we stay with a remote, central appointment.

Q426 Chair: What do you prefer?
Gareth Davies: There is a balance here. For independence, it is stronger to have central appointment, but in competitive market and local choice, it is clearly better to have local appointment. That is the policy choice that is being made here. I do not think that we should pretend that it does not put greater pressure on auditor independence; it puts the auditor in a more exposed position—particularly as currently drafted—when things get very difficult, but I think that it is likely to lead to a more competitive market and possibly lower overall fees.

Q427 Chair: Can you just expand on “as currently drafted”. So—
Gareth Davies: In the Bill?
Chair: Yes, go on.
Gareth Davies: As you have already heard, from Steve Freer, the Bill—
Chair: The nature of the audit.
Gareth Davies: Yes, but the Bill also needs to be much clearer about how the auditor’s costs will be reimbursed if we get into one of these special cases. They are rare, but they do happen. At the moment, you can see that it says, essentially, that the auditor may charge the audited body for the cost of the work. Well—

Q428 Chair: Just out of interest, I do not want to name and shame, but do you any of you audit a foundation trust that is in financial difficulties at present?
Sarah Howard: We both audit foundation trusts.

Q429 Chair: Are they in financial difficulties?
Paul Woolston: I personally do not have any but, back to Ian’s point, actually, if you look at any foundation trust at the moment, with the demise of PCTs and the advent of CCGs, you would be concerned about their income, going forward. You are alive to that all the time.

Q430 Chair: I will help you on this, because we are looking at it all the time. There are 20 that are in real financial difficulties. There is the £20 billion of cuts that they have got to find, so they are all going to be—okay, transition creates a bit of a hiccup and I accept that, but I do not take that overly seriously because the reality is that it will be the same people turning up in a new organisation. But, undoubtedly the financial pressure on trusts is growing and in the past, when it was all one big family, you robbed Peter to pay Paul. That is no longer going to happen.

Heather Wheeler: That is how they got in the mess in the first place.
Chair: That may be right, but that was there, so there was always an underpinning that way.
Sarah Howard: On that point, Chair, I think it is worth emphasising that we spoke a lot about public interest reports, which are sort of the extreme form of formal reporting. Auditors report in many other ways, routinely, in public, to their audited bodies. Annual reports go to councils, hospitals and other bodies which are made public and can often be very critical, so the public interest report is an extreme of that. The other point to make in relation specifically to foundation trusts is that Monitor, as I think you will have seen in your earlier evidence session, is a highly effective regulator. It is actually very good, in its own monitoring, at identifying and reporting publicly those matters.

Q431 Chair: I hear that, but it is you—you are pretty keen on this landscape.
Sarah Howard: Pardon?
Chair: You are pretty keen. I accept that about Monitor, but we do not want Monitor simply to replicate what you do. This is all testing your independence and testing, in the new landscape, whether there will be a genuine, real intervention, where needed.

Paul Woolston: In some respects, I think it is easier with those extreme cases of financial difficulties, because we would be wanting to draw that to the attention of management as early as possible, and to gauge their reaction to the situation. We would be on top of that all the time—reporting it to the audit committee and to the board—and we would probably increase our level of reporting in those circumstances.

Q432 Ian Swales: To ask that question a slightly different way, should we be concerned about, if you like, the fragmentation of this? I am thinking about my local council, which the Audit Commission has recently said is running up the biggest debts in the country in proportion to its size. That sounds like a simple statement, but if they were not talking to each other, it could not make that statement. If it was not the Audit Commission but a local firm down the road, they would have had absolutely no way of knowing. Are you satisfied that, in this public interest area and so on, your organisations will have the mechanisms to do the kind of commentary and assessment that the Audit Commission is doing now?

Sarah Howard: That is a really important point. Fragmentation and co-ordination are themes that have come through the various evidence sessions. How can we ensure that in the draft Bill? There does appear to be a gap there; that is a risk. One of the benefits of some form of national or regional procurement body is that it could fulfil some of those other functions and help address some of the other risks.

Q433 Ian Swales: My last point is the obvious one about the going concern of a foundation trust, for example. If we have different firms in different localities doing different work, it is highly likely that we will not get exactly the same opinion about a similar situation, because they will take a different view, whereas now we would be more likely to get a similar opinion, I think.

Gareth Davies: An issue such as a going concern is very well covered by auditing standards. It is probably less likely that you would get inconsistency of
approach there; it is more of a problem when it comes to issues such as benchmarking and value for money. That is not something that you can do as the auditor of an individual body on its own; you need a scale to make sensible comparisons.

Q434 Ian Swales: Will your firms be putting something in place between yourselves? Is that something that you talk about, or are you all just expecting to have separate local practices?
Gareth Davies: Well, of course, we are competing with each other. That is a stronger dynamic in the new framework than it has been in the Audit Commission framework, where there was a more collegiate set-up. The truth of it is that we will do that if we think that there is an advantage to us in doing so as individual firms. Part of the offer of individual firms will be, “We can offer you a good benchmarking service as part of our audit, because of our coverage.”

Q435 Mr Bacon: Paul Woolston, you said that the new regime could actually lead to an increase in reporting and hasten the bringing to management’s attention of relevant matters by the auditor, whereas you, Gareth Davies, said, “We shouldn’t pretend that it doesn’t put greater pressure on the independence of the auditors.” They both sound very plausible, but they cannot both be true. Can they and, if so, how?
Paul Woolston: I think they can. Our starting point would have to be that we are independent; that is why we are drawing these matters to the attention of management.

Q436 Mr Bacon: Gareth Davies, do you agree with that?
Gareth Davies: I agree that you do not survive very long, as a firm of this kind, if you do not demonstrate your independence in everything you do. The real difficulty is the broad scope of public audit. If this was just about the opinion on the accounts, you would err not on the side of caution, but on the side of flagging things up.

Gareth Davies: We would all say, coming from reputable firms, that we would always do the right thing in any situation. However, having been in those situations, I am aware that when issuing difficult reports to extremely reluctant councils, councillors and managers in the rare cases that it is necessary, to know that the Audit Commission is standing behind you is extremely powerful.

Q437 Mr Bacon: So you mean that if you err, you would err not on the side of caution, but on the side of flagging things up.
Gareth Davies: We would all say, coming from reputable firms, that we would always do the right thing in any situation. However, having been in those situations, I am aware that when issuing difficult reports to extremely reluctant councils, councillors and managers in the rare cases that it is necessary, to know that the Audit Commission is standing behind you is extremely powerful.

Q438 Mr Bacon: If I can tease that out, you are saying that in this new world you might be even more willing, I think you said that it could actually lead to an increase in reporting. Why do you think that is the case?
Paul Woolston: I was comparing it to public interest reports. I think it is much better to report early to management than to wait for a public interest report to be published. In that sense, it might encourage people to raise matters a bit earlier.

Q439 Mr Bacon: But do you feel, like Mr Davies, that the auditor is in a somewhat weakened position knowing that they have not got the Audit Commission standing behind them—or would not have in the future—in the way that he describes?
Paul Woolston: I do not feel that it makes that much difference to me, to be honest.

Q440 Mr Bacon: If you are in the middle of an audit, and you are thinking of flagging something up, is there, in the back of your mind, the thought that if this all goes horribly wrong and there is an inquiry and all the documentation and the emails come out, you want to be able to show that you professionally did the right thing? Is that always ticking around in the back of the auditor’s mind?
Paul Woolston: Absolutely. Our internal systems would look to flag that up as well. Even if there is not a financial problem, you would have had to have been doing the right thing because it is monitored to such a degree.

Q441 Mr Bacon: I have just one more question for Sarah Howard. You have described the other tasks for a national body, if there were one. Do you think that it is going to be possible to do the right amount of benchmarking, measuring and comparison that is required in the new audit regime? Given what is currently proposed, what might you see as a way forward if you do not think that there is sufficient scope at the moment.
Sarah Howard: That is a really important area. It is twofold. One is benchmarking and comparative data that could be provided from a number of sources, including from the sector itself. I know that in your discussion with the LGA, they talked about some tools they have available, for example. Partly, it is about comparative data that could come from a number of sources. Some of that has been provided in the past by the Commission, like the value for money profile tools and so on, but that would not necessarily need to come through the audit base. That is one thing. In addition to that, there is the useful information that can be collated from the output of the audits. Again, I think you had some useful discussions with the Audit Commission on that.

Q442 Mr Bacon: But if they are not there, who is going to do it?
Sarah Howard: Exactly.

Q443 Mr Bacon: Is it necessary to have some unit of this kind doing that at the centre, or—I am agnostic about this—are these tasks which could or should be taken on collaboratively by a body like the LGA?
Sarah Howard: Potentially. It comes back to questions such as, “Do we need a list of auditors?”
Well, probably yes, if the National Audit Office or anybody else wants to try to collate some of the information that through your discussion you agreed would be useful. Certainly, locally, working with local authorities, they do find it useful. Those who are performing well and are competitive want to know that they are at the top.

Q444 Chair: I am a little worried about all this. You have said as well, Gareth, that we can offer data that allow you value for money. The National Audit Office is going to have the duty to do VFM reports, even though it is a small number. How on earth is it going to be able to collate the very different data? How are you going to relate to it? What you might think is important in Yorkshire will be different from what you think is important elsewhere. London will be very, very different from—

Mr Betts: The Audit Commission has struggled with these allegations that you get inconsistency of data.

Gareth Davies: It will only happen if somebody is prepared to take the lead and specify that it would be useful for something to be known nationally, for whatever reason, so it should be collected on a consistent basis.

Q445 Chair: But they will not know that it is useful to know nationally until they know it, if you see what I mean. It is only when you have got the good data that you are able to say, “Ah, there is something there that we ought to”—

Gareth Davies: If you are dipping into a sample, as presumably the NAO will to carry out its studies, even though it is a small number, it is possible to say, “We are seeing two or three different things here. It would be useful to know what the national picture is on this.” So it could be triggered by some of the work that is envisaged.

Paul Woolston: Audit bodies themselves instigate benchmarking exercises. They can even compare one with another, or with a group. The other thing I would say is that increasingly the public sector is interested in benchmarking itself with the private sector. So I think that benchmarking is a very wide area, and typically it is done best where the local authorities get themselves together and seek to benchmark.

Q446 Chair: But PWC will decide that benchmarking on one issue is important in one way, Grant Thornton will do another in another way and Mazars will do it in a third way. At the moment you have at least got the Audit Commission telling you, “You have got to do it like this, guys,” and you set about it. We know from the NAO that they will not have a big capacity, so they will be very dependent on the data they get from you.

Paul Woolston: It is some time since we have done some real benchmarking exercises with the Audit Commission.

Q447 Chair: What does that mean? That sounds like a real loaded statement.

Paul Woolston: The sort of benchmarking exercises that were carried out early on in the life of the Audit Commission—we have tended not to do that recently.

Q448 Chair: What does that mean? Sorry, I am literally ignorant as to what that means.

Paul Woolston: It would be wrong to assume that we are doing a lot of benchmarking at the moment because of the Audit Commission being here over the past few years.

Heather Wheeler: In effect, you use the AGA tool or you use APSE, or that sort of thing. You would not do it through this.

Q449 Mr Betts: Back to this overarching body of some kind, there are two issues. One is about procurement, where particularly for smaller authorities there probably will be some benefit in having that. That is what the evidence has been, I think. It may well be that joint procurement will happen anyway; even under the terms of the Bill you can see the LGA or somebody else starting to pull this together. But it is not purely about benchmarking as an overview or somebody looking down from the top; it is about using the information gained in audit to help form a national picture where things are happening across the board. Presumably, there is a real problem about drawing together things under the Bill, because each auditor will have a confidential arrangement with their council, won’t they? It will not be quite as simple as wanting to share information that you may gain with anybody. Isn’t that going to be a real problem?

Gareth Davies: As Sarah said earlier, quite a lot of the product of the audit—the annual letter to the governing body of the organisation—will be in the public domain. That needs to contain anything significant coming out of the audit, because clearly it is the main vehicle for reporting the findings. What it will not have is detailed cost information and that kind of data. It would be possible to trawl the annual letters from every auditor and identify the extent of financial stress for a particular sector, judging by auditors’ reports.

Q450 Mr Betts: Could that possibly work as well as the current arrangements do in that regard?

Sarah Howard: It would be difficult without some form of national co-ordination to pull together the results of audits across the country, whether that is in terms of timeliness of preparation of accounts, whether the accounts have been audited, the outcome of the audit or how well, for example, local authorities are dealing with a particular issue—those sorts of things. That is useful information to local authorities, but it would need to be co-ordinated and you would need a national list. That is where some of those administrative functions could usefully be performed if there was some sort of national procurement body.

Q451 Mr Betts: Can I raise two other issues? One is the fragmentation of responsibility. It is not merely the auditor panel or the audit committee, but at national level. I think I could probably explain fairly easily to someone what happens now and who is responsible, but I have had to go back and read the report several times—I have had a look at it a few times now with the Select Committee Report before—and trying to work out which body or which set of
initials does this, that or the other confuses me. Is it likely to be a confusion that carries on for people working in this field generally? Have you got concerns about that?

**Gareth Davies:** There is a risk of that. What it is lacking at the moment is a clear co-ordination of the whole system.

**Q452 Chair:** Who should do that? The same old body?

**Gareth Davies:** Not necessarily, because obviously it is not going to be there. There is possibly a role for the National Audit Office in convening something. As audit firms in this market, we are going to have to interact with: the NAO; the FRC, which we obviously already do, but in a new area of work and on a wider scope of audit; and our supervisory bodies, whichever institute it is, rather than just the one organisation now. Not only for our personal convenience, but, probably more importantly—who is detecting the messages emerging from this regime as it develops? Which issues are auditors dealing with more or less successfully? Does that mean the guidance or the code of practice need to be tweaked? How is that going to happen if there are a lot of bilateral relationships in the new set up?

**Q453 Chair:** We had that interesting exchange between the FRC and CIPFA. Where do you guys stand on that argument?

**Paul Woolston:** Which in particular?

**Q454 Chair:** The FRC said, “We do this work at the moment. It’s just a little more of the same. It’s not that hard. We can do it.”—I hope that I am not doing them an injustice. CIPFA said, “Actually, public sector audit is very different.”

**Mr Betts:** It is the point that Gareth Davies made.

**Q455 Chair:** Where do you stand on that?

**Paul Woolston:** I think that it is still unclear actually. In terms of the Bill, it would be much better if it is clearer.

**Q456 Chair:** What is clearer? The scope?

**Paul Woolston:** The scope and relationship—who does what—should be much clearer about which role the FRC is taking. The notion of reflecting the different nature of public services audit.

**Q457 Mr Betts:** Should that be a requirement in the Bill to direct the FRC in that direction?

**Paul Woolston:** Yes, I think that would be helpful. What you are alluding to is that Marcine Waterman at the Audit Commission can at the moment bring us all together and we can discuss these things about emerging trends. It may be that because we have different bodies together, having a small unit like that—currently called the Audit Commission—may be useful, because it is able to bring the various bodies together as a co-ordinating organisation.

**Q458 Mr Bacon:** We obviously cannot call it the Audit Commission—we had this discussion already with other witnesses—because it would be insufficient saving of face, we have to find a new name. Have you any suggestions for what we could call it?

**Paul Woolston:** A name? No, I have not.

**Chair:** We will leave that to Michael Heseltine. Do you want to comment on that in any way, Sarah?

**Sarah Howard:** In relation to the quality monitoring, that is not an area of great concern in the Bill. There are other areas of risk that we have touched on. The FRC currently does quality monitoring of public sector audit work. As Steve said, currently public sector audit work is unique. There is the wider scope. It would need some gearing up to become familiar with that wider scope. That would not be an area of real concern.

**Gareth Davies:** I share Steve’s broad point that this wider scope is quite an important issue for quality monitoring. Monitoring is very hard on the basis of a file review; the FRC model is of a very detailed file review to check that you have given the right opinion on the accounts. That works well for the opinion on the accounts, because it is international standards of auditing and so on. It is much harder to do a file review and say, “Should the auditor have said more about the governance arrangements of this local authority or have said something about value for money?” That is not going to leap out at you from standardised audit tests in the same way. I just think it needs more work and more thought on how we are going to ensure a basic level of consistency on that wider part of the audit.

**Q459 Ian Swales:** Whistleblowing is obviously a key part of the control system in an organisation. Can you say something about how you in future would see working with any whistleblowers and what protections might be needed in the Bill? At the moment, clearly a whistleblower has the Audit Commission, which they would see as independent, public and as people that they can talk to. They might be more reluctant to approach what they might see as a commercial firm that is very closely connected to the organisation they work for. Can you say something about that? I think that it is vital that we make that side of things work, possibly better than it does now.

**Gareth Davies:** Actually, I think it works quite well now. The auditor at the moment is identified as a person to whom whistleblowing disclosures can be made, and that includes auditors from the firms, as well as, until last month, the commission’s in-house auditors. I think that works quite well. I have not encountered examples of people resisting the fact that it is a private firm that they need to make that disclosure to. I think that is one bit where the current arrangements can essentially roll forward reasonably straightforwardly.

**Sarah Howard:** Yes, I agree.

**Paul Woolston:** If it helps, I spoke to a whistleblower last week, or they spoke to me, and they did not have a problem speaking to someone from the firm. Often, the relationship in terms of how you deal with a whistleblower is embodied in the terms of reference for an audit committee, and is often referred through internal audit first, but there is a resort to come to the external auditor as well.
Q460 Ian Swales: I have two supplementaries. First, should we make sure that the routes to do that are absolutely clear to everyone? Secondly, the Bill is largely silent on whistleblowing, even though it is a key part of the control structure, so do we need anything in the Bill about, for example, protection or anonymity of whistleblowers? Do we need to say anything that is not being said?

Paul Woolston: My personal view is that it is not necessary to put it in the Bill, but to ensure that it is picked up in the Court of Audit practice, or in best practice in ordinary standards.

Q461 Ian Swales: Do you mean the organisational codes of practice?

Paul Woolston: Perhaps the code of audit practice that the NAO produces might have some reference to it.

Gareth Davies: Whistleblowers’ interests are protected by separate legislation. Public interest disclosure legislation governs that, and already applies when disclosure is made to the external auditor.

Ian Swales: Thank you.

Q462 Chair: One final thing. We are told the fees are going down in big authorities. I do not know what is happening in smaller authorities. Do you want to talk a little about how the pressure on fees will happen, and whether over time some authorities will gain and some will lose? Will you also comment on what you do when you do not want to do the work for a particular authority, for one reason or another, perhaps because Clive Betts or Margaret Hodge is the leader? You never know.

Sarah Howard: As a general opening comment, I think the strong national procurement has undoubtedly been effective.

Q463 Chair: That is really what you all want. Do you want that, Paul?

Sarah Howard: It is effective in—

Chair: Paul is pulling a face.

Sarah Howard: Cost and quality. That would be my opening statement. In the absence of the national procurement, I think you will see variation in fees among the plums and lemons as they have been called.

Q464 Mr Bacon: Can you tell us who the lemons are?

Sarah Howard: Well, perhaps the remote, smaller authorities. One of the benefits of the national procurement is that we are able to mix them up—the postage stamp effect. Overall, some may go up, and some may go down because there may be highly competitive situations in the large urban authorities. It is difficult to predict, but I think there will be pressure on fees in the absence of the large volume contracts and the huge discounts we are able to offer, the efficiency we benefit from in procurement costs, and some of the indemnities that we have talked about—the public interest issue. I think there will be pressure going forward.

Paul Woolston: When there is an open market, I think the fees will come down across the board, including smaller organisations. That is my view. My team audits academies as well as a unitary authority. It is important for us to have a portfolio of clients, and I think there will be plenty of competition.

Q465 Mr Bacon: When you say it is important for you to have a portfolio, do you mean it is important when you are bidding for, say, an academy to show that you already audit some academies?

Paul Woolston: Yes, and for our people. We want a range of work.

Q466 Ian Swales: This happens to be a hobby-horse of mine, and I know that the Public Accounts Committee has this specific subject coming up this side of Christmas. How are you appointed to academies? Who appoints you, and who do you report to? How does it work at the moment?

Paul Woolston: I am not sure, it is not one of my accounts, but I understand that it is the governing body.

Q467 Ian Swales: In that case, the governing body is effectively the audit committee.

Paul Woolston: If it does not have an audit committee.

Q468 Ian Swales: We quickly run to the idea of big local authorities talking about this, but the Bill must apply to many different types of organisation. It is interesting. Do either of you know about academies?

Gareth Davies: The Bill will not apply to academies, as I understand it, because the Bill reflects the Audit Commission regime and academies are outside that regime.

Ian Swales: I can see the extension.

Chair: I am just having drawn to my attention—I had forgotten it—that in the accounts for academies as a whole in 2010–11, the NAO could not provide an opinion because a whole lot of key data were missing. There were inadequate arrangements and processes to provide assurance over any of the data supplied, missing data from a significant number of academies and low data quality issues with the returns. The NAO estimated that the academies submission omits assets totalling £4 billion. That is a bit scary. We will undoubtedly be critical in the PAC, but I would rather not be critical; I would rather get it right.

Q469 Heather Wheeler: I am interested, on the back of this, that having gone through this all this angst, we will have independent audit committees. I know that we are slightly getting ourselves mixed up with academies and otherwise, but, particularly on NHS things, have you guys been accused of not being independent enough or even being selected unfairly? How do you cope with accusations like that, or do you not recall ever having been accused of that?

Sarah Howard: The key difference in the NHS is that it is not political in the way that local government is.
The issue of independence is more complex in local government, because you are dealing with councillors and local electors. The audit committees in the NHS do have non-executive directors—indeed people—on them. It is hard to compare, because currently local government is political and audit committees do not have that independent representation. For me, the key risks therefore are around local electors and their perception that the auditor is not independent and the difficult positions that councillors may put themselves in, because they will be open to that accusation. We deal a lot with local government electors who complain to the auditor about various things. I can assure you that that independence is critical.

Q470 Mr Betts: It is perception as much as anything else.
Sarah Howard: Absolutely.

Q471 Heather Wheeler: At this point, I should declare that Grant Thornton does my council, and PwC does my hospital, so well done.
Mr Bacon: Questions will be asked in the House.
Q472 Chair: Gareth is looking for some business there. Looking through, we have covered most of the areas. Is there anything that you wanted to say about the legislation as it now stands that we have not given you the opportunity to put in evidence about?
Sarah Howard: Just to reiterate, Chair, if I may, the whole concept of the auditor panel, which we have not dwelt on, is a compromise between having an independent appointment or a fully effective audit committee. It feels like it is a compromise that does not meet either of those.

Q473 Mr Bacon: It is a bodge, is it?
Sarah Howard: For those reasons, there are complications with it.
Mr Bacon: Bodge reasons.
Sarah Howard: Finally, Chair, I am conscious that we have not spoken about small bodies. I do not want to go over the detail of that, but we have made some comments on that, and the NALC submission was very thoughtful and we would agree with its comments.
Chair: I think that it is a pretty straightforward issue.

Q474 Mr Betts: So you all agree on the idea that the panel has not been a good solution.
Gareth Davies: If we go for local appointment, let’s have proper audit committees that take their responsibilities seriously.
Chair: Why is the DCLG not listening? Perhaps they will.
Mr Betts: Who thought of the idea of the panels, if nobody seems to be recommending it? Is it a mystery to be solved.
Chair: Thank you very much. We have Lord Heseltine in 10 minutes, so if people want to have a tiny break we can then go to him. Thank you so much for coming, we are very grateful.

Examination of Witness

Witness: Lord Heseltine gave evidence.

Chair: Welcome, Lord Heseltine. Thank you so much for coming.
Lord Heseltine: It’s a pleasure.
Chair: We are hoping that you can help us. We were reminiscing that, when you established the Audit Commission, you had in your sights Clive Betts and M. Hodge here, who, among others, you were trying to bring to stronger public account, as I recall—
Lord Heseltine: Persis the truth.

Q475 Chair: Some of us around the table feel that the circle is going around, and I wanted you to give us some of your wisdom, experience and thoughts, as the Government have now decided that they are going to abolish the commission that you created. What are the key aspects that you will be looking at to ensure that the rationale for its creation, which probably has not changed, is maintained in the new arrangements?
Lord Heseltine: Independence of appointment to a central body, probity and value for money.

Q476 Chair: It is interesting because all our witnesses have talked about independence of appointment through a central body, which means that you have got to establish some sort of central capacity—we thought you might come up with a name, actually—not called the Audit Commission to do that. At the moment, the idea is that the local authorities through an audit committee of some sort or another would appoint their own auditors, which is back to where we were before the introduction of the Audit Commission.
Lord Heseltine: I would not do that.

Q477 Chair: Okay. That is clear. If we look at value for money, at present the Audit Commission sets the framework for audit and does the value-for-money reports. Some of the criticism has been that it spread itself too widely, tried to do too much, but under the new arrangements the data will be collected by private, independent auditors and some of us find it rather difficult to see how you will ensure the proper comparison across authorities and therefore be able to start getting a handle on value for money. So what there would be your view?
Lord Heseltine: I think your question answers itself. You have got to have a system that systemises the process of comparing value for money and like-for-like services. This is not the private sector, there is a vast range of different and complex services. There is no common means of evaluation and if you want to make comparisons authority by authority, you
have to prescribe the information that you want to collect, and that can only be done centrally.

Lord Heseltine: Because we lost the election. But I have a long memory, so when I returned in 1979, I asked where the plans were that I had put in place in 1972. It was no great surprise to me that somehow they had been mislaid, and nothing had happened. So I began the journey again, and if my memory serves, in the first of the local government Bills I introduced in the new Parliament of ’79, I failed to get the Audit Commission in, because—can you believe it?—the Treasury resisted the idea.

Q478 Chair: So in your view, the Audit Commission has not necessarily outlived its effectiveness?

Lord Heseltine: I have not seen any argument to suggest it has.

Q479 Mr Bacon: There is an argument we have just heard that central appointment is plainly better for independence, and local appointment is better for competition and local choice, although, as one of our witnesses just said, one should not pretend that local appointment does not put greater pressure on the auditors. But we have also heard auditors saying that their own professional independence ought to be an adequate safeguard. Are you saying, essentially, that independence is necessarily compromised in cases where councils appoint their own auditors?

Lord Heseltine: There is a pressure to get reappointed, and the language cannot avoid the word “compliance”. You do not want to get a reputation for being difficult. I have to tell you that I think there should be such a process in central Government. I tried to get that when I set up the Audit Commission. I also happen to think that there should be a similar process in the private sector. The arguments are the same, but they are even more intense in the public sector because of the complexity of the services it offers.

Q480 Mr Bacon: And you cannot sell the shares in the public sector if you do not like what is being done.

Lord Heseltine: Well, we have done our best.

Q481 Chair: We haven’t done a very good job. I can tell you that we on the Public Accounts Committee worry about the value for money of some of that as well.

Lord Heseltine: This is trespassing on your tolerance, but your report on the regional growth fund did not give me a lot of pleasure.

Q482 Chair: The money should have been got out there. I am thinking back to when you established the Audit Commission. You were very keen then to have private auditors do the audit, and in the end that did not happen. Now we have more of a mix. I know there was a bit of a mix, but it tended to be the old way: the district auditor went in to the Audit Commission, and that became the basis for the audit of local authorities. Now it will be entirely private auditors. What are your views on that? Why, at the time when you were establishing the Audit Commission, did you go for a different mix of institutions that were responsible for audit?

Lord Heseltine: You have to go back another Government to when I started on this journey, under Mr Heath. Then the auditing was all district audit, and I began the process of introducing private audit alongside the district audit. It made no progress at all—

Q483 Chair: Because?
to think that there is a body of people with sufficient power and influence in each locality to burrow into every local authority account to come up with every set of statistics that will enable them to exert political pressure. You only have to take it step by step to realise that it is not a concept that has any teeth in it. To me, beyond the probity and integrity of actually adding up the books and making sure that there is no one fiddling them and that there is nothing missing, which is very important, comparative studies of value for money are absolutely an essential part of what the public sector should always be on its guard to do. So across a very wide range of public sector activity—I would probably go the whole range—I believe in that sort of process. I do not see what other creative pressure there is to bring the results that are attainable.

Q487 Chair: The argument is that you have all this data out there—all expenditure over £500—and the local electorate will, in the end, be responsible. That is the argument.

Lord Heseltine: All 25% of them.

Chair: Or less. It’s wonderful; we agree.

Q488 Ian Swales: Given that this Bill implies a move a bit more towards a private sector type of model, what do you think the learning would be from the private sector—either good or bad—that ought to inform our thinking? I am thinking particularly of the pressure on audit fees, meaning that the private sector might demand the minimum level of audit, which could happen in the public sector under these provisions. What do you think we ought to learn from that?

Lord Heseltine: This goes back to the independent body laying down standards that are appropriate and that would not permit a cheapskate audit, which is what you are implying. I am not saying that there would be such a thing, but that is what you may have to make sure does not happen. In fairness to the auditing profession, in the private sector today there are very real standards, and compliance with them is observed very widely, so it can be done provided that somebody is laying down the standards and making sure that they are maintained.

Q489 Ian Swales: So national standards. I think you implied from your value-for-money comments a few minutes ago that you would want to see some pretty clear definition of scope in the Bill of what is expected to be covered. Also, you implied earlier data standards for that part of the work as well, so national standards for audit and then a definition of the other work on top of that?

Lord Heseltine: Yes. If you want to exert local pressure—I would be much keener on doing so than many people; there is not much manifestation of it, but I would like to go much further in encouraging it—and you want it to work, then somebody has to be able to say that to empty a bin in South somewhere or other costs something and it costs twice as much in North somewhere or other elsewhere. Unless you can provide that information in a form that is credible, that debate is unlikely to take place.

Q490 Heather Wheeler: Could perhaps the LGA bring this together? Only two councils are not members of the LGA.

Lord Heseltine: The Local Government Association is a body representative of local government. I think you need a body representative of the taxpayer, and that is central Government, because that is where the money comes from.

Q491 Mr Betts: Coming back to the point about independence, the Government propose that audit panels be set up with perhaps some independent membership. There have been suggestions that we might simply enhance the existing audit committees on local authorities with independent members and maybe an independent chair. After all, that is what happens in the health sector. NHS trusts are audited in that way. They appoint their auditors—the foundations trusts do—and they have independence on the audit committee. Is that not a way of ensuring independence within local government as well?

Lord Heseltine: Depends what information they are provided with. They can be no better than the facts in front of them. If they do not have comparative facts about the costs of dispensing a prescription in one authority as opposed to another, for example, they cannot make the sorts of judgment that you are talking about.

Q492 Chair: Can I just move on a little bit? One of our concerns is that the Audit Commission—I think probably after your time—took over responsibility for monitoring health. I do not know whether you did that or whether that came later—it came later. We have now the evolution of independent foundation trusts that appoint their own governing bodies. It is a bit self-perpetuating, so there are so-called elections in a locality to appoint new members, and they appoint their own auditors. We in the Public Accounts Committee have observed this a little.

Up to 20 of the new foundation trusts are in deficit, and more are in financial difficulties—I have probably got my figures a bit wrong, but it is of that order—and yet there has not been a public interest report from any of the auditors, appointed by the trust bodies, who are responsible for the audit of those trusts. It is all in an environment where there will be less money for health with the deficit reduction programme. Finally, the Department of Health has so far not put forward proposals as to how it is going to ensure accountability and allow us to follow the taxpayers’ pound in this new landscape. Have you any thoughts on that?

Lord Heseltine: Yes. You are the Public Accounts Committee, not me.

Q493 Chair: Is it satisfactory to you?

Lord Heseltine: As you describe it, of course not, but the way you describe it may not be the way the Government would describe it. I do not have the brief or the experience to have a view.

Q494 Chair: Equally with academy schools? There will be a similar position where they will be
independent of local authorities with their own governing bodies able to appoint their own auditors.

Lord Heseltine: All my answers will always be based on the same starting point. You need financial integrity and proper financial auditing—adding up. No theft or anything like that. But if it is public sector money, you need value for money, because there is no equivalent in the public sector that compares with the competitive process of the marketplace. Frankly, the systems are so much more complex that if there were a marketplace, I think it would still be quite difficult to do and to be sure that you were getting value for money. As there is no marketplace, and you are dealing with monopolistic circumstances, the only way to ensure that you are getting value for money is to have the figures analysed for comparative purposes—one organisation compared with another. That is the intellectual rationale that I believe to be right, and I don’t know of any alternative.

Q495 Chair: This has been such a clear bit of evidence. Is there anything you feel that we haven’t asked you that we should?

Lord Heseltine: In the piece of paper that I have here, there is a lot of reference to savings—£160 million over some years. It would be interesting to know what the Audit Commission thought they had saved on their value-for-money services over an equivalent period. When you think about the scale of value for money—in this case, in the local authority service—a minuscule part of 1% is a huge sum of money. I am quite a long way removed from all this, but I know that, in its time, some pretty dramatic figures were produced as a result of the comparative value-for-money services.

Let us just start with one of the recommendations in my recent report: the district councils should be permitted to become unitary county authorities, if they so wish. You may not know, but I did this by prescription in Scotland and Wales in the 1990 reorganisation and did it permissively in England. The advice to me is that £10 million or £15 million a year reorganisation and did it permissively in England. The prescription in Scotland and Wales in the 1990s was sufficiently disciplined not to be either, how much more competitive would they be in the world marketplace? You have a double whammy, but the fact of the matter is that the Government’s statistics show 60% over time or budget.

Q499 Mr Bacon: The central criticism of the Audit Commission seems to be that it was a very good idea, but it got top-heavy, burdensome and bureaucratic. Certainly, from talking to local councillors, they would say that the various iterations of it, such as best value, the comprehensive performance assessments and so on, became really very burdensome. They would say that, wouldn’t they? But it is also true that there was, I think, a quite widespread view that it had started to lose its way. On its value-for-money reports, the quantity had increased and the quality had declined. What is the way of making sure that you get all the things you want from a central capacity without its bloating and becoming burdensome?

Lord Heseltine: Change the chairman. It is no more complicated than that.

Q500 Mr Bacon: Just the right management?

Lord Heseltine: Just the right management. Always show me the guy at the top when you’ve got a problem.

Mr Bacon: Very clear.

Chair: Thank you very much indeed.

Lord Heseltine: Glad to have been here.

Chair: Short, sweet and I think we agree. We are very grateful.

Lord Heseltine: A great pleasure.

Chair: Thank you very much indeed.
Tuesday 27 November 2012

Members present:
Margaret Hodge (Chair)
Mr Richard Bacon
Mr Clive Betts
Meg Hillier
Mark Pawsey
Mark Reckless
Ian Swales

Examination of Witness

Witness: Tom Winsor, Her Majesty’s Chief Inspector of Constabulary, gave evidence.

Q501 Chair: Welcome, Mr Winsor. Thank you very much for agreeing to help us this morning. I am going to ask you a general question and then we will go into the specifics. Our job is to look at the Bill, as it stands, and then to see whether there are problems with or gaps in the current clauses and whether there are risks to the effective delivery of services. From your perspective, having—I hope—had a little chance to look at the Bill and from the point of view of ensuring proper accountability for police services and the new police and crime commissioners, do you see any gaps or risks in the Bill? Are there any amendments that you would have wanted to see?

Tom Winsor: Thank you, Chair. If it would assist the Committee, I will take a moment or two to explain HMIC’s role. That will then lead into the discussion of gaps and risks. Is that acceptable?

Chair: Fine.

Tom Winsor: Very briefly, HMIC was established a very long time ago in 1856, and its principal instrument is its voice. It is not a regulatory authority with the power to issue orders, write enormous cheques or take enforcement action, but it does have a voice that is listened to, and it is charged with reviewing and, in a number of respects, assessing the efficiency and effectiveness of policing. That is what we do. We have powers of inspection, including powers of entry to obtain documents and access to people, and we publish reports. That includes profiles on value for money, which we publish on our website, and there is now a new obligation that reports, rather than being given to the Home Secretary, are published directly to Parliament. They provide information in relation to a whole range of measures concerning policing. We also co-operate with other organisations and, until now, the Audit Commission on a number of important aspects concerning policing. As you know, I have only just taken over as Chief Inspector of Constabulary. I am still making an assessment as to the resources and the performance of HMIC. I am impressed with what I find so far, but there is always room for improvement.

One of things that I intend to do that is directly relevant to your question in terms of gaps, overlaps and so on is to publish very shortly a conspicuous statement of the promise that we—HMIC—will make to the police service, the police and crime commissioners, the Home Office and the public generally on our criteria and procedures for action, explaining very precisely what it is we do, what criteria we apply. The statute says “efficiency” and “effectiveness”, but what does that mean in practice and what should our procedures be?

I take very seriously, which you may know from my record as rail regulator a number of years ago, that there is a fundamental obligation on public authorities that those within their jurisdiction have a right to be treated fairly. I also take very seriously the duty to explain what it is we are doing and why we are doing it. In that respect, and under those two headings, we carry out our functions. It would be a mistake for anyone to believe that HMIC has the obligation of micro-managing police forces. That is a matter for chief constables, and I do not think that that is seriously in doubt. So I hope that is helpful.

You mention gaps in the Bill. The scheme of the Bill, as I have been able to discern it, is to alter the structure of auditing local bodies but not to alter the standards, the nature and the purpose of auditing, which remain stable. Nevertheless, there are some gaps. There is a perfectly justified public concern that bodies subject to inspection, audit, monitoring, enforcement, regulation, etc. being held to account should not be overburdened with multiple requests from different organisations, perhaps operating according to different criteria.

Under the Police Act 1996, there is a right of veto for the Chief Inspector of Constabulary if he is satisfied that an inspection or some kind of regulatory action by another authority, including the Audit Commission, would impose an unnecessary burden on the entity being audited. He then has the power to direct that that should not proceed. That power of veto applies to the Audit Commission but, on my reading of the Bill, does not apply to the new local auditing bodies or to the National Audit Office, in so far as it chooses to do value-for-money assessment. It seems to me that that is a mechanism it would be wise to carry forward into the new regime.

Q502 Chair: Is that the main thing? Anything else, particularly with the new police and crime commissioners—I know it is really early days, but do have any observation that you think is appropriate as Government are determining and Parliament is considering legislation in this area?

Tom Winsor: As we all know, police and crime commissioners are a very new invention. We shall see how they behave. It seems to me that their need for information from the local auditing bodies, which will be appointed by the PCCs concerning their police forces, is undiminished. In fact, the PCCs will be
It would be mistaken to assume that HMIC is going to the existence of it is enough, but it seems to me that no circumstances in which it has been used, because from what I have been able to determine, there are circumstances in which the Audit Commission have a note as to whether it has been used. My knowledge on this is not perfect. I can let the Tom Winsor: Not to my knowledge, but my knowledge is not perfect. I can let the Committee have a note as to whether it has been used. From what I have been able to determine, there are no circumstances in which it has been used, because the existence of it is enough, but it seems to me that it would be mistaken to assume that HMIC is going to act as the protector of a police force.

Q503 Chair: And what about auditing the PCCs themselves? Tom Winsor: The PCCs have the enormous advantage of being democratically accountable. Chair: I think we will take a deep breath at that one.

Q504 Mr Betts: Why is the power of veto you currently have with regard to the Audit Commission necessary? And can you give a couple of examples of circumstances in which you think it might be necessary for you to use it? Tom Winsor: As I said, I have only just started, so I have no knowledge of it having been used in the past. I think that the power of veto is necessary. The statutory criteria for the power of veto are that the inspection or action by the other authority would be unduly burdensome on the body being inspected or audited. It seems to me that the very possession of a power of veto and the strength of that power mean that it is very unlikely ever to have to be used, because the reality is that the bodies in question really have a strong need to co-operate and co-ordinate. There is also a statutory obligation on my office under the Police Act 1996 to co-operate and co-ordinate our functions with those of the Audit Commission, and therefore, it should be carried forward to the local accounting bodies as well.

Q505 Mr Betts: I can see the duty to co-operate because, clearly, there can be an overlap in work that is carried out, but the veto seems potentially to be a weapon—for want of a better word—that could relieve police forces of the same degree of action by an auditor that a local authority was subject to. If life gets difficult, they always have you to fall back on, haven’t they? Tom Winsor: Well, that assumes that HMIC is going to be any kinder or gentler to police forces than a local auditor would be.

Q506 Mr Betts: So why give the power? That is what I do not understand. Tom Winsor: The power has been there for a very long time.

Q507 Mr Betts: But it has never been used. Tom Winsor: Not to my knowledge, but my knowledge on this is not perfect. I can let the Committee have a note as to whether it has been used. From what I have been able to determine, there are no circumstances in which it has been used, because the existence of it is enough, but it seems to me that it would be mistaken to assume that HMIC is going to act as the protector of a police force.

Q508 Mark Reckless: Mr Winsor, do you know when HMIC took this veto power that you describe? Tom Winsor: I don’t know when it was put into the Police Act 1996, but it is long-established, as I understand it.

Q509 Mark Reckless: But the Audit Commission extension of powers in respect of police forces was in the 1996 Act. We agree on that, do we not? Tom Winsor: Yes.

Q510 Mark Reckless: It is possible that the power you refer to, and describe more as a general veto, was actually brought in to the 1996 Act to guard against concerns about the new Audit Commission power subjecting the police to too many inspections. Tom Winsor: It looks that way, because otherwise they would have given the veto power to the Audit Commission and we would have had to stand back.

Q511 Mark Reckless: So with the Audit Commission being abolished, does that not mean that the veto power for HMIC is no longer necessary? Tom Winsor: Yes, but the Audit Commission’s functions are just being transferred to local auditors appointed by the PCC, in the case of police forces. It seems to me that if the veto power had a real, valuable purpose, which I believe it does, under the Audit Commission regime, it should also be extended to the local accounting bodies, because otherwise the problem at which it is directed—namely, unnecessarily burdensome and intrusive regulatory oversight—could not be tackled in the way that the present statutory scheme provides for.

Q512 Mark Reckless: But surely police authorities were involved in auditing their police forces before 1996. Tom Winsor: Yes.

Q513 Mark Reckless: And that was the point when the Audit Commission was brought in, whereas your previous answer rather suggested that the audit role that has happened for local police forces, generally overseen by the police authority, is somehow part of the Audit Commission role. Was the Audit Commission not something separate that came in in 1996? Tom Winsor: I am not sure that I follow. The power of veto was retro-fitted into the Police Act 1996 some time in the past—I do not know when. My only point is that the legislative purpose in creating the power of veto was to prevent unnecessary regulatory intrusion. Given that the audit function concerning police forces is not being diminished—it is just being transplanted to local bodies—the power of veto should still be there.

Q514 Mark Reckless: I suppose my suggestion to you is that the power of veto, which you described as a general one, was actually brought in specifically to deal with concerns expressed when the Audit Commission’s role was extended to an oversight of police forces that it previously did not have. You are now trying to keep that veto power to stop the normal
local audit that went on previously with police authorities and will now be done by PCCs.

Tom Winsor: If I implied that it was only created to stop the Audit Commission doing things, I am sorry: I did not mean to say that. It applies to a number of bodies, not just the Audit Commission. In fact, the Audit Commission is the last on the list. It applies to inspections by the Chief Inspector of Prisons, the Chief Inspector of the Crown Prosecution Service, the Chief Inspector of Probation, the Care Quality Commission and, last on the list, the Audit Commission. The Secretary of State may add, by order, additional bodies to that list.

Q515 Chair: So this is secondary legislation. Has it ever been used, that power of veto?

Tom Winsor: I don’t know. The research that I have been looking to do so far has thrown up no instance in which it has been used, but we can find that out. I just can’t tell you now.

Q516 Mark Reckless: Mr Winsor, are you seriously suggesting that HMIC should have or should potentially exercise this power to prevent the previous regime—a police authority but now a police and crime commissioner—undertaking the audit it sees fit of its police force?

Tom Winsor: Only if the proposed action would be unduly burdensome. The idea that HMIC would conclude that a local auditor, appointed by a PCC, looking at the affairs of a police force, should back off and just not do it, that is not the case.

Q517 Mark Reckless: So why have the power?

Tom Winsor: Well, Parliament has created this power and it seems to me that the purpose of the Local Audit Bill would be to transfer largely intact the existing legislative scheme into local hands, with the same checks, balances, limitations and restrictions that previously existed. So, if it had a case before, the case for its abolition has not been made. The absence of the transfer of the power of veto from the Audit Commission regime to the new regime is probably just a mistake.

Mark Reckless: I suggest that that power was introduced as a result of concerns about the Audit Commission extending its empire into policing when there were perfectly sensible audit arrangements there already. Although you refer to these various other bodies you can veto, there is no evidence of HMIC ever having done so. With the Audit Commission being abolished, there may no longer be a requirement for this veto power, to the extent that it was brought in specifically because of the Audit Commission taking over that role.

Chair: I think it is an omission, actually. I agree with you, having read out that list. It is a thing they can do on an order; they do not have to do it in the Bill. Probably, Mark, it is a minor thing that we can draw attention to in our report.

Q518 Mark Reckless: Can I broaden the scope for questions rather than go further on that point? Mr Winsor, what is your opinion of these so-called independent auditor panels that are going to be advising or arguably constraining the PCC in his or her choice of auditor? Do you believe that they will ensure an independent audit? Are they performing a useful function?

Tom Winsor: Sorry, the quite elaborate procedure for the appointment of the auditors and the requirement to consult the local auditing panel?

Q519 Mark Reckless: Yes.

Tom Winsor: It seems to me that that is a perfectly sensible mechanism. It may be that it is an abundance of caution on the part of the architects of the legislation to ensure that the cosy local arrangements do not become unwholesome. I do not have any anxieties about that. I think that the PCC, in making his appointment of a local auditor, will have little difficulty in complying with what is largely a sensible statutory scheme.

Q520 Mark Reckless: And little difficulty in persuading the auditor panel to sign off on whatever his recommendation is?

Tom Winsor: We will have to see. In the Bill it seems to me to be a sensible mechanism.

Q521 Mark Reckless: Compared with the previous arrangement, in which a police authority had responsibility for that audit and obviously a large range of additional responsibilities in respect of its police force, we are having this independent auditor panel, whose role seems very limited. As I understand it, it appears to be separate from the police and crime panel. If it is basically just meeting to sign off the recommendation of the auditor, will it have sufficient substance genuinely to challenge a PCC where that would be necessary or appropriate?

Tom Winsor: It depends on who is on it, but it will have a majority, as I understand it, of independent members and an independent chair. I think that the statutory scheme is quite coherent, in that this will be a separate body from the police and crime panel, because it will have a separate and rather limited function, which is simply ensuring that the appointment of the local auditor is sound.

It is not an incoherent system, because, as I understand it, the scheme of the Bill is to bring local auditing more into line with the statutory scheme for companies in the private sector under the Companies Act 2006. In those circumstances, the shareholders appoint the auditors every year at the annual general meeting. I do not have any real anxieties about the PCC being tied in knots about this independent auditor panel. The PCCs do not have, under the Police Reform and Social Responsibility Act 2011, a completely free hand to trample all over the policing landscape.

Q522 Mark Reckless: So in your analogy, you would see the auditor panels as akin to the shareholders approving the management of the PCCs’ proposal for the auditor?

Tom Winsor: Yes. At the end of the day, the private sector auditing regime has been found to be perfectly robust, and there is no central body that appoints auditors for private sector companies. They can
choose their auditors. This may be a subject for a further question, but at the end of the day, the auditors have their professional reputation to maintain and their professional bodies regulating them. Having been in professional practice myself for 30 years, I can tell you that your professional reputation is far more precious to you than any single client, as Arthur Andersen shows.

Q523 Ian Swales: I would like to explore the police and crime commissioner role a bit more. My area, Cleveland, is sadly a bit notorious. It is the first force to sack the chief constable for a long time, a couple of months ago. In an interesting piece of symmetry, the previous chair of the police authority was charged with perverting the course of justice on the very day of the PCC elections. A new person has been elected, who walked in on his first day, sacked the chief executive, and appointed one of his known colleagues to the job—last Monday. You have used the words “checks and balances” and the expression “cosy arrangements” in your evidence today. Locally, we are concerned about how the new arrangement is going to work.

My specific question to you is, at what point does HMIC’s work start and finish, opposite the probity of a particular police force? To what extent are you yourselves going to be involved in looking at the arrangements in one particular police force?

Tom Winsor: As I mentioned, our remit is much wider than that of local auditors, who are very much focused on finance and accounts. We are looking at efficiency and effectiveness on a much wider scale. Probity in the police force is a much wider concept than just the management of money and resources; it is the behaviour of leadership of the police force and many other factors.

Under the Police Reform and Social Responsibility Act 2011 and the statutory scheme provided for under it, the role of the Inspectorate of Constabulary in chief officer appointments has been diminished, if not extinguished, although we retain a role in the removal of chief constables. That is the scheme that Parliament has alighted upon. PCCs, with their democratic legitimacy, will be left to make these appointments and to assess the probity.

Q524 Ian Swales: Just to build on that, are you, as the inspectorate, going to look at and judge all the arrangements that are in place, for example how effectively the PCC role is working in a particular force? Or do you regard that as outside your remit?

Tom Winsor: Before the Police Reform and Social Responsibility Act came in, HMIC assessed the efficiency and effectiveness of the police authorities as well as the police forces. That has changed—we now do police forces, and the electorate will assess the efficiency and effectiveness of police and crime commissioners.

Q525 Ian Swales: What if, for example, in another nice twist, the previous chief constable was sacked for—well, there were other things, but the actual thing he was sacked for was favouring somebody in an appointment? Here we have a new PCC favouring somebody in an appointment on their very first day. I hear what you are saying about the electorate in four years’ time, but what happens for four years? Do you have any role in saying, for example, “Actually, that particular lack of transparency in an appointment is something we should be concerned about”? Or is that going to be outside your remit? If it is outside your remit, should the auditors be looking at it, or does this person have a completely free hand?

Q526 Ian Swales: Let us extend it. We are bound to have a case somewhere in the country where a PCC decides that the way to sack a chief constable might just be because they do not like the person. At what point does the inspectorate have any say in that, or do they not? If they do not, that is fine, but we are exploring accountability and the checks and balances in the new system, because that interfaces with what we are talking about with the Audit Commission.

Tom Winsor: The first limitation on the power of the PCC to sack his or her chief constable is the statutory scheme established by the 2011 Act, which requires the inspectorate of constabulary to express an opinion and provide a report. The chief constable in question has quite an elaborate right to be heard in his own defence, and the police and crime panel are also involved, so the chief constable is not going to be subject to some arbitrary dismissal. There is also the common law right to be treated fairly. Clearly, the chief constable is entitled to be dismissed or required to resign on grounds that have substance, rather than just the personal chemistry between him and the PCC.

Q527 Ian Swales: Finally, I want to explore the appointment of auditors. You used the expression “cosy local arrangements.” That is often a feature of life in some parts of the country. We have heard evidence from other witnesses who say that they accept that the Audit Commission is going, but quite a number of other witnesses have asked, as Mr Reckless said, whether the new audit panels will have anything of substance to do, attract the right kind of people and be sufficiently independent. Do you have any concerns in that area, and do you feel that there is any case for saying that the national appointment of auditors should somehow continue? I know that that is not in the Bill, but are you happy with what is?

Tom Winsor: Yes, it seems to me to be a coherent regime. As I understand it, 50% or more of the local auditing work is done by private sector providers anyway. They are subject to the code of audit established under the national scheme, they are subject to the statutory requirements as to what the quality, nature and scope of the audit must be, and
they are subject to their national professional rules. As I mentioned earlier, a professional services firm that chooses to disregard that is extremely unwise and will have a short life.

Q528 Ian Swales: Going back to the role of the HMIC, presumably you will not see it as part of your role to do any second guessing, or inspecting whether the arrangements, for example, of the appointment of auditors are being done with due process, probity and everything else. That would be outside your remit, presumably.

Tom Winsor: That is an interesting question. It is clearly not efficient or effective for the statutory scheme for the appointment of auditors to be violated. If information were to reach us or if we were to find information of that kind, that might well be a matter of concern for us.

Q529 Chair: Ian raises an important issue, because this is all about how the new structure will work in terms of accountability. If an allegation of poor practice in the way that the PCC executes his or her responsibilities emerges, is that something for you to look at? In the past, the Audit Commission probably would have looked at it. I am being told by an adviser that they would have done it. It is interesting that Ian has come up with this at such an early stage in the development of the new regime. Are you responsible? Is the auditor responsible? Or is it just the electorate in four years’ time? This is a chief executive appointment, not a chief constable one.

Tom Winsor: In terms of the PCC going through the process for appointing the auditors, it is under the statutory scheme, which is entirely outside the remit of HMIC. We do not inspect or regulate the behaviour of the PCCs.

Q530 Chair: So nobody would look at the allegations that Ian has raised. Who would be responsible for looking at the allegations that arise out of what Ian has said about what is happening in his local area?

Tom Winsor: If the statutory scheme for the appointment of an auditor has been violated—

Q531 Chair: He wasn’t talking about an auditor. He was talking about a PCC coming in, sacking her chief executive, who is not the chief constable, and putting in place—an allegedly—his—

Ian Swales: Somebody he knew. Let us put it no stronger than that. It has been reported in the press. I am not making this up. You can check it in the press.

Chair: Sorry, we have to be careful what we say.

Ian Swales: What we are indicating is that all the problems in Cleveland police arose out of whistleblowing, not auditing or inspections or whatever, and one of the themes from our pre-legislative scrutiny is to make sure that we know what the route of intelligence and whistleblowing is.

Chair: It is a bit unclear.

Ian Swales: In these big issues, it is less clear, because we do not have a national Audit Commission to go to any more in the new regime, and HMIC has a clearly defined role. What I am exploring is how it interfaces with the new arrangements that have been put in place.

Q532 Chair: Who should Ian go to?

Tom Winsor: I apologise if I misunderstood. I thought we were talking about sacking the chief constable. You are talking about sacking the chief executive.

Q533 Ian Swales: I am sorry if I confused you. I also spoke about the chief constable, but this particular real case last Monday concerns the chief executive of the police force—the PCC’s staff—who was instrumental in sorting out the corruption, which is ongoing.

Tom Winsor: It is not a matter for HMIC. We do not regulate, inspect or report upon the behaviour of PCCs.

Q534 Chair: So who is it for?

Tom Winsor: If the appointment is questionable—if, for example, it is unlawful—it is open to anybody with an interest to apply for a judicial review of that decision on the grounds of illegality. If it is irrational beyond the legal test, that could be JR-ed as well. If it is corrupt, the Prevention of Corruption Act 1958 and the common law concerning that would apply.

Q535 Mark Reckless: Surely your answer to that last question also applied to violation of the statutory scheme for the appointment of the auditor by the PCC. I think you were saying that that was a matter for the efficiency and effectiveness of the force and therefore HMIC would get involved.

Tom Winsor: Yes, but we must look at the efficiency and effectiveness of the police force, not the efficiency and effectiveness of the behaviour of the PCC. I expressed no view as to whether we ought to, but Parliament has spoken under the Police Reform and Social Responsibility Act 2011, and it is not for us to suggest that Parliament got it wrong.

Q536 Mark Reckless: You were saying that we now have a coherent system; surely, it is a matter for the police and crime panel to provide that oversight for the PCC and ultimately the electorate.

Tom Winsor: That is right.

Q537 Mark Reckless: In terms of the inspection regime—I understand if you do not have this to hand, given that your appointment is recent—we heard a suggestion just now that HMIC audited police authorities in the past. Is it not the case that the power of both HMIC and the Audit Commission to audit the police authority that is meant to be auditing the police force is relatively recent? It extends back no more than five years.

Tom Winsor: I think you are right.

Q538 Meg Hillier: I will try to ask quick-fire questions, so do not be worried about giving us short answers. First, have you been consulted by the NAO on the code of practice that will be used for auditing the police?

Tom Winsor: No, I do not think so.
Q539 Meg Hillier: You haven’t. Do you have any concerns with the code? Now is your chance to tell us.
Tom Winsor: We have not yet been consulted by them. I think that it would be appropriate for us to do so, once the Bill has a corporeal form, and we will.

Q540 Meg Hillier: So you do not have any comments on the code as such at the moment.
Tom Winsor: Correct.

Q541 Meg Hillier: Under the new regime, do you think it will be possible to do proper benchmarking across police forces, comparing performances nationally and measuring how things are going? From other witnesses, we are picking up that the loss of the Audit Commission means that the overarching work will be done very differently by the NAO, which may do only four in-depth studies a year on that comparative work.
Tom Winsor: It is of interest that HMIC does value-for-money now and has done for a very long time. The NAO really ought to have a rather limited role in that respect, given that we are already benchmarking forces. We have very significant resources of expertise to understand how police forces work. The organisation has been around for a long time. We assess their use of resources; use of procurement; staffing, which amounts to almost 80% of their costs and sometimes more; performance, in terms of detections, public satisfaction and crime rate; and efficiency. What would there be for the NAO to do, given that we do all that and have done it since 1856? I think that the answer is not very much.

Q542 Meg Hillier: That is very helpful, because, “What’s the role of the NAO?” was going to be my next question. If you look at what is happening now with auditors, one of the challenges is about how we get data that are of a common standard, so that other people can do the analysis and look at comparators, and so that the police and crime commissioners can do their own comparison work. How will you interact with auditors to ensure that that performance information is usable, useful and can indicate what is value for money for PCCs, and anyone else who might be interested in the analysis?
Tom Winsor: We publish value-for-money comparators for each police force on our website. They assess their performance according to the measures I mentioned and others and compare them with their nearest comparable force in terms of size, geographically, make up and so on. That work is already done.

Q543 Chair: But who collects the data to enable you to do that work?
Tom Winsor: We collect the data.

Q544 Chair: If I may say, you are actually placing an additional burden on police forces, because at the moment the data would be collected for local authorities through the Audit Commission doing their audit. You do not have a double—auditors and inspectors going in and getting a different dataset.
Tom Winsor: Correct.

Q545 Chair: And that is not very satisfactory from the point of view—
Tom Winsor: That is why the power of veto is there.

Q546 Chair: No, I think you misunderstand the question. At the moment, if the Audit Commission does a national benchmarking, value-for-money study on any aspect of local government, it is based on data that the auditors collect while doing their audit. If the auditors in the new world of the police forces we totally independent and decide their own basis for doing the audit, you will not have comparative data on which to do sensible benchmarking, which will be useful to the public and to the PCCs. I accept that you are new to the job, but it is rather worrying that you have not identified this as an issue and made appropriate representations. You should frame the audit framework so that you have the data that you need to do the VFM studies.
Tom Winsor: We will have that data because we are the primary source of information.

Q547 Chair: No, you won’t.

Q548 Meg Hillier: Who do you collect it from? Who is collecting it for you?
Tom Winsor: The Inspectorate carries out inspections of forces all the time.

Q549 Chair: You must have the data in a form that allows you to compare one force with another force.
Tom Winsor: We collect the data in the form that we find useful to make the comparisons as clearly as possible. We have statutory data-gathering powers in that respect.

Q550 Chair: But that is a duplication, Mr Winsor.
Tom Winsor: We do not get the data from the auditors.

Q551 Chair: But, Mr Winsor, then it is a duplication. You yourself have said that you want a power of veto to prevent duplication. You are duplicating what auditors do.
Tom Winsor: No, I already have that power. It is Parliament that is contemplating taking it away.

Q552 Chair: You are not answering. That is a neat point. You are not answering the issue of substance, which is that, if you demand data of the police services, the auditors demand data and it is different data sets, it is extra work for the police services that might be better spent on front-line policing.
Tom Winsor: The police service receives data requests from all sorts of sources, which is why the statutory scheme under schedule 4A of the Police Act 1996 exists. You may be aware that I carried out and reported finally in March 2012 a review of the pay and conditions of the police service, and made a number of observations in relation to efficiency. In recommendation 49 of my final report published in March this year, I recommended that the data burden on police forces be streamlined and simplified, and that police forces and HMIC should be required to
produce a template in that respect—I had no expectation that I would be the one who had to do it—a force management statement, which is an annual assessment of the condition, capacity and capability, service ability, performance and security of supply of their assets, a look forward to the demands made on the force and how they were resourcing themselves to do that.

That information that police forces already need to have. If they are properly managed, they need to have that. If there were a national template requiring that information to be collected to a particular standard in a particular form, it will relieve the multiple data request burden that police forces presently face and also assist everyone to make valid comparisons on a like-for-like basis.

Chair: I have tried twice. Mark, very quickly, because we are running a bit late, then Richard and then Clive.

Q553 Mark Reckless: Does not this really date back to the 19th century regime of the Home Office driving its creation of modern police forces and the power of the inspectorate in terms of efficiency and effectiveness, and the dependence of the Home Office grant on that? Is the comparison with local government necessarily a helpful or appropriate one to make for the police in this area?

Tom Winsor: The 19th century regime was in strong recognition that, at that time, all policing is local. The centralisation by the Home Office—the statutory scheme that we are considering today—is being diminished. Nevertheless, it seems that there is a case for forces being encouraged and required to collect and to produce data in a common form. PCCs will want to know not just how their force is doing, but how their force is doing in comparison to the most comparable forces, which may be next door or 100 miles away. Therefore, having that information on a consistent like-for-like basis will be of some advantage to them. It will also be of advantage to the police forces in question. I am talking about streamlining and simplifying, not adding to an already heavy burden.

Q554 Mark Reckless: Can you clarify where the responsibility for setting those common standards lies?

Tom Winsor: The recommendation in my report, which I have not yet had an answer on, is that HMIC should do it.

Q555 Mr Bacon: Can you confirm that you agree with what Lord Heseltine said when he told the Committee that it is vital that there is a systematic process and common methodology for “comparing value for money and like-for-like services” across local authorities. You are saying that that approach should be available in the constabularies as well—is that right?

Tom Winsor: Yes.

Q556 Mr Bacon: I am slightly at a loss—and perhaps in disagreement with some of my colleagues—about this method becoming over-burdensome. It sounds to me that what you have said in relation to the auditors, and your role as in inspector, is rather analogous—there might be some differences—with the role of auditors in the Prison Service and HMIP, who has statutory powers including certain statutory rights of access, access to information and so on. Is that a fair comparison?

Tom Winsor: I do not know enough about the prisons regime to answer your question.

Q557 Mr Betts: Do you expect the costs of audit to rise or fall for police services as a result of these new arrangements?

Tom Winsor: We have not made an assessment, but I can give you my expectation as a former economic regulator. I would expect that the costs will fall because I think that there will be a greater degree of local audit activity. Provided that they are doing it within the national framework, they will not have the heavy burden of a national organisation ahead of them. But time will tell.

Q558 Mr Betts: So that will fall, even compared with the recent fees obtained by the Audit Commission on its most recent procurement exercise. You see a substantial fall?

Tom Winsor: I am not in a position to make a projection. I would expect that the costs would not be higher, and I suspect that they will be lower.

Q559 Mr Betts: So you will have procurement costs for every individual police service as opposed to one procurement cost nationally?

Tom Winsor: I doubt very much whether procurement costs will be very high at all. As I said, I have been in professional practice for all my time, and we never charge the procurement costs to the client.

Q560 Ian Swales: Can I clarify something? When you used the words “national framework”, were you referring to a purchasing framework or just the coding framework?

Tom Winsor: The coding framework.

Q561 Mr Betts: Do you have any concerns about downward pressures on quality of audit?

Tom Winsor: No, because the national code, and indeed the statute itself, specifies what the standard will be, and the rules of professional practice do so also. I would doubt whether quality will fall.

Q562 Mr Betts: Can I come back to the nature of public sector audit compared with the private sector? You said a few minutes ago—this slightly worried me—that it will all be all right because the private sector is audited according to a certain set of rules and we can do the same in the public sector. But the scope of public sector audit is fundamentally different. Do you have an appreciation of that?

Tom Winsor: Yes, I do.

Q563 Mr Betts: So why the simple comparison? You mentioned that it is all right because the private sector shareholders appoint the auditors, so it is all independent, but when you are dealing with the police and crime commissioner, you are dealing with one
individual. He has not got the shareholders there; he has got to go to an audit panel for advice but, in the end, it is one person’s decision, and one person who is being audited. Where is the scope for independence in that?

**Tom Winsor:** The independence comes through the statutory scheme whereby the PCC must go through the local auditing panel before he can make the appointment in question. It is not solely his decision.

Q564 Mr Betts: But in the end it is his decision, having taken that advice, isn’t it?
**Tom Winsor:** Yes, that is right.

Q565 Mr Betts: So he is not really independent?
**Tom Winsor:** Well, he is independent in the sense that the statute requires him to make the decision having followed the statutory process of consulting and taking into account the advice of an independent panel. But, in the end, he must make the decision on—

Q566 Mr Betts: So it is very different to shareholders in a private company, isn’t it?
**Tom Winsor:** It is different in those respects, yes.

Q567 Mr Betts: Can I draw a comparison? Currently, the Audit Commission is independent, and very clearly so. If you were appointed by an election among all PCCs who are solely accountable to you, you would not be independent, would you?
**Tom Winsor:** Of course you would be. Your independence comes not from the source of your appointment but from what they can do to you after you have been appointed. The Committee does not have time for me to tell you about the difficulties that I had when I was an independent regulator of the railways. I was appointed by the former deputy Prime Minister, now Lord Prescott. Once he had appointed me, he and his successors, Mr Byers and Mr Darling, had no power to give me any directions at all, so much to the point that in October 2001, the Government were prepared to introduce emergency legislation to take me under direct political control.

The independence of my office was a thorn in the Government’s side. It was a barrier to their achieving their objectives, and my independence was defended successfully. There is no question but that my office was both legally and behaviourally independent, even though I had been appointed by a Minister.

Q568 Mr Betts: So is the independence of all of the auditors of police services in the future adequately protected in terms of their dismissal?
**Tom Winsor:** It seems to me that it is.

Q569 Mr Betts: Why do you think that?
**Tom Winsor:** Once they are appointed, they cannot be removed unless they violate one of the conditions in the statutory scheme or their terms of appointment. If a PCC were to try to remove auditors on grounds that deserve public criticism or that were unlawful, then he, the PCC, would be subject to severe criticism and possibly legal challenge, and the independent police and crime panel would be holding him to account.

Q570 Mark Reckless: Is there any reason to think that auditors appointed under this scheme will be any less independent than you have demonstrated through your own history as a regulator?
**Tom Winsor:** No.
**Chair:** Thank you very much indeed. Many thanks for your time.

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**Examination of Witness**

**Witness:** Amyas Morse, Comptroller and Auditor General, National Audit Office, gave evidence.

**Chair:** This is the second time this morning.
**Amyas Morse:** Very nice to see you, Chair.

Q571 **Chair:** We meet a slightly different group of people, but we have very similar issues. We are slightly short on time because we have the Secretary of State coming, but what we are looking at is the Bill as it stands on the abolition of the Audit Commission. Our task is to see where the gaps and the risks are and what changes you would like us to recommend to Parliament. Do you think that the Bill as it is constructed gives you a model of good governance? If it does not, why not?
**Amyas Morse:** You will recollect, Chair, from my previous testament to the Communities and Local Government Committee that I, carefully, am neither a proponent nor an opponent of the legislation.
**Chair:** Neither are we.
**Amyas Morse:** Of course that is right. What I think is that it is workable. It is not the only workable model, but it is a workable model. The proof of the pudding will largely be in the implementation and in how we work to improve that implementation over time. I welcome the fact that the legislation and the commentary on the legislation contained the comment that there would be a post-implementation review, and that shows its sensible openness to development as we go forward, and that is very necessary. Having said that, I have a couple of comments that are worth making. The development perspective and the openness to develop is critical to ironing out everything, and we will see in a few years’ time how good the working model is.

The first comment I would make is that the Government should carefully reflect on the proposals for audit panels. There is scope to build on existing audit committee arrangements. Clive Betts’s suggestion of a double lock, with the auditor’s appointment agreed by both the audit committee and the whole council, is a very sensible one—I think that that could work. I also reiterate my previous comment that there needs to be independent representation on such a body, on the audit committee making these selections. I mean independent of both elected members and officers. I still believe that that visible
Amyas Morse: I am not suggesting to you that is all in place at the moment and nor am I defending it, I am simply saying that in my view there is no reason in principle why the LGA could not do that.

Q572 Chair: Interrupting you, when we asked the LGA for information on the use of personal service companies by local government, its information was appallingly incomplete, to such an extent that we will have to have them back.

Amyas Morse: I am not suggesting to you that is all in place at the moment and nor am I defending it, I am simply saying that in my view there is no reason in principle why the LGA could not do that.

Q573 Chair: Does it not need statutory underpinning? The whole point, in a way, is that if you are really going to get the data the LGA is an organisation that brings together local government. I was going to ask you another question in relation to that, because you are suggesting that some of your value-for-money studies should be done in consultation with the LGA, so local government would in a sense be telling you what studies it wants rather than perhaps ones that might be in the best public interest—there is a bit of coyness in there.

Amyas Morse: Shall I finish this question and then answer that one? Just to be clear with you on our view, we have only looked at the methodology and not what’s in it, and they are in early days yet. I just do not see it as inimical that the LGA could prepare information across the sector—there is nothing axiomatic that says that that could not work. Going then to the question of whether we would in a sense be telling you what studies it wants rather than perhaps ones that might be in the best public interest—there is a bit of coyness in there.

Amyas Morse: Shall I finish this question and then answer that one? Just to be clear with you on our view, we have only looked at the methodology and not what’s in it, and they are in early days yet. I just do not see it as inimical that the LGA could prepare information across the sector—there is nothing axiomatic that says that that could not work.

Q575 Chair: In what way? Expand that a bit. Amyas Morse: There are various issues where, if the Department is asking questions about how individual authorities are functioning, if it shows active interest in that, and if it sees published reports from auditors and picks them up and asks questions about them, that will make it efficient. If it is curious and constantly on the alert, that will send a message through the whole system. That really makes a difference, because in the end, it is the sponsoring body.

Q576 Mr Bacon: Does not what you have just described need to be done well, with information well collected and systematically processed according to a common basis so that the Department has the wherewithal to compare the different authorities that it is looking at? Amyas Morse: Yes, that is helpful, and to the extent that the information exists at the moment, it is valuable and important, and should be preserved. I agree with that.

Q577 Ian Swales: You talked about whistleblowing, and there is an issue of what happens in the new regime if things are found not to be right. At the moment, as I understand it, the Audit Commission could expand the scope of what it does and act in the public interest in a relatively unfettered way. As I understand the new arrangements, there will be a funding issue, because the audit and its costs will be agreed. The auditors might go to an organisation and say, “You’ve no idea what we’ve found here. We’ve got a lot more work to do.” How will that work. How will it function? It could result from whistleblowing as well.

Amyas Morse: Talking from my private sector experience, which is, as you know, extensive, the fee statute to allow me to do that, and I certainly express the intention that we will do that.
is agreed, but it is not cast in stone. If a huge amount of extra work is needed because an issue arises, the work will be done, and there will be a debate about payment.

Q578 Ian Swales: But in that environment you would expect that if the public body concerned had agreed a fee, and the professional auditors say there is more to do because they have found something or there has been a whistleblower, it would be billed for that work.

Amyas Morse: Let me put it this way. Anyone who has a statutory audit appointment has a professional duty to investigate and plumb out any issues they find, and make a full and thorough report. If they do not do so, or if they are prevented from doing so for any reason, they cannot sign off and they should not sign off a clean audit report because they have not completed a satisfactory examination. To be clear, if they found an issue that was serious and not foreseen when they started their work, they would have to do that extra work, and then I think they would quite legitimately expect to recover the cost of that work from the local authority.

Q579 Ian Swales: Do you see any risk—I do not want to cast aspersions on a profession of which both you and I are members—that that could be abused, or that firms could beef up the size of their work as a result of finding things and making the audit bigger? Do you see that being a risk?

Amyas Morse: There is always a risk like that. That is why you need a good Audit Committee. Many people round the table have experience of local government. Considering you’ve got more continuity in the elected body and working with the executive team, for the auditor to turn up and say, “I’ve just found something and I’m going to make you pay for it”—some bodies I visited felt they had a lot of work done on value for money under the previous regime, which they were not always that appreciative of. So if you put them in the position that they are the customer and they can drive back against any fees they are being given, I would have thought that that works quite well.

Q580 Ian Swales: Just a final point on this. There are various other regulatory things in the private sector. You also have audit panels in companies. Should the proposal be stronger, so that if the auditor goes into an organisation and is not happy, the audit panel themselves have more of a role at that point?

Amyas Morse: I would expect that to be the case.

Q581 Ian Swales: Is it strong enough in the Bill, do you think?

Amyas Morse: It looked that way but I’m not going to pretend I have examined it in great detail. If you said to me, “Would the auditor have power to seek audience with the audit committee?”—I am quite sure that they do have that power under the Bill—in that case, by telling them formally of issues, they are putting the members of the audit committee on warning. It would be very difficult for the audit committee to ignore those points.

Q582 Mark Reckless: How are your preparations going for taking on the code of practice?

Amyas Morse: Well, thank you. There is a degree of uncertainty about when we will be taking that up. Our plans at the moment are that the next iteration of the code will happen in 2015. We are expecting to work alongside the Audit Commission in preparing those plans. We have taken on people with Audit Commission backgrounds and other appropriate expertise to let us do that and we are confident of being in a position to do it.

Q583 Mark Reckless: How many people have you taken on in that respect?

Amyas Morse: Particularly, only a couple, but we will see as we move forward. There has been discussion about whether we would take some people from the Audit Commission and that may be appropriate.

Q584 Chair: How close will your code of practice be to the Audit Commission’s?

Amyas Morse: Quite close. I don’t think there is much wrong with their code of practice, so ours will be quite close to it.

Q585 Mark Reckless: And will the code of practice on its own be enough?

Amyas Morse: No, it won’t. Thank you for asking me that. The most important thing is not the code of practice on its own but the detailed guidance that the Audit Commission has been in the practice of giving and we certainly think we need to be in a position to give. We need that to be a feature of the Bill and the implementation of the Bill.

Q586 Chair: Have you got the powers in the Bill at present?

Amyas Morse: No, I don’t think we do and we would like to have those powers.

Q587 Chair: So it is powers, not just to establish the code but to publish guidance at regular intervals.

Amyas Morse: Yes, and to give guidance on the interpretation of the code and effect guidance to auditors who ask us for it.

Q588 Mr Bacon: What are the dangers if the draft Bill isn’t amended so that you do have the power to issue supplementary guidance?

Amyas Morse: The danger is that the code itself is at quite a high level and it is capable of too much flexibility of interpretation on its own. If I were an auditor I would be uncomfortable with the level of guidance proposed in the draft Bill without detailed guidance to go alongside it.

Q589 Mark Reckless: What would be the status of this detailed guidance?

Amyas Morse: It needs to be obligatory on the auditors to pay attention to it. Does that mean it should be in the legislation? It might be possible that it could be done under an order rather than through the legislation itself.
Q590 Meg Hillier: We have had quite a lot of discussion with witnesses about the role of the NAO in taking value-for-money studies forward—quite different and quite strong opinions have been expressed about this. First, do you think that the Local Government Association should be the lead authority for the improvement agenda in future? Do you think that in the draft Bill there needs to be any redrafting to make it very clear what the NAO is going to be responsible for? They are bidding for that work in their evidence to us.

Amyas Morse: I am not sure that I think we need anything in the draft Bill on this. I think what we mainly need is to have a close working relationship with the LGA, and we intend that we will do that. My view of it is that I think there is nothing wrong at all with LGA being seen in the role of encouraging and driving improvement. But, clearly, if we are finding something contradictory in our value-for-money work, we need to talk to them about that and make sure that they are not on different pages.

Q591 Meg Hillier: The chief executive of the LGA talked about a reference panel. Is that set up?

Amyas Morse: We have a reference panel now, as part of our development of our relationship with local government. We keep that in place and we get considerable guidance on our approach from it.

Q592 Meg Hillier: In that arrangement, you talk considerable guidance on our approach from it. I think that—what I do not want to do is scope creep, where we start covering areas that were not envisaged originally. I think that would be concerning to people in local government.

Amyas Morse: Right now we have in what I will call the devolved and local space about six studies going on. That is our planning assumption. We need that with the relatively modest resources we have already requested, which was roughly a 10% uplift in resource. If it becomes obvious that we need to do more, we are perfectly happy to do more, but I have to say that I think that—what I do not want to do is to have scope creep, where we start covering areas that were not envisaged originally. I think that would be concerning to people in local government. In terms of what I will broadly call national study territory, which is where you look across and you draw significant lessons across local government—for example, one study we have planned for before the 2013 recess will be on local economic growth—if we find that it became obvious that we should be doing studies at a higher rate, we are perfectly capable of going to the TPAC and requesting funding to do that. This is a starting position that we have taken, and I am more than happy to be adaptable to it, seeing what need there is.

Q595 Meg Hillier: One interesting thing that has come up in evidence is that the NAO’s not commenting on policy—it follows the money—might limit what your VFM studies could do. I wonder whether you have any comments on that. I suppose, in a sense, it is about what would be different between the NAO study and the Audit Commission studies, and whether that is a good thing or a bad thing.

Amyas Morse: Okay, I think our studies will be quite similar to some Audit Commission studies—those which tended to look across the sector more broadly—and that is our intent. That is where we intend our focus primarily to be. What I do not see and am not thinking of, is following the money into seeking access into individual bodies to make examinations of our own. I do not think that would be welcomed by the sector and it is certainly not what we have in mind.

Q596 Meg Hillier: We talked about the financial resources. Again, there has been a suggestion that you could bring on board experts within the Audit Commission to help you develop this strand of work. Do you think you have the right people in the NAO to do the sort of work that you are going to be taking on? Are they adaptable or do you think you need to be looking at that kind of approach?

Amyas Morse: The place I can see us having active discussions about bringing people on board—I am not going to commit to it at this point—is, as I have already said, in the code space. That is the main financial audit activity that is going to be different and it is not clear to me that I need any more people other than in setting the code of audit.

Chair: We just had evidence from Her Majesty’s Inspectorate of Constabulary. Interestingly enough, his view is you should lay off them: they will do it than in setting the code.

Mr Betts: It would be burdensome, I think he said.

Chair: You would be burdensome.

Q597 Meg Hillier: On health, as well, we have heard interesting things. It is an interesting new landscape. Does the NAO think it has any role in health, as well? Maybe you could wrap the two answers together.

Amyas Morse: That is quite right. I am going to be quite robust here: I think we should be looking at constabulary and health. I know it will not be welcome to the inspectorate of constabulary, but we have done a considerable amount of collaborative work with them. We work well with them, and we provided quite a lot of input. Therefore I think that having an overview of what is happening in policing, more broadly, and working alongside that body, would actually be quite valuable. There is a lot of money going through there. As far as health is concerned, it
Q598 Meg Hillier: That brings me to a more general point about data. We have talked about the code and so on. We heard quite clearly from Tom Winsor from the HMIC about what data are collected and how comparable they are—we had an interesting discussion on that. The danger is that you are going to have different auditors going into different sectors: you are going to have different bodies doing different bits of audit, if you have HMIC and yourselves looking at the police. Who is going to make sure that the data that are collected and provided by local authorities in whatever sector are in a form that is comparable between them and maybe even across sectors? What role do you think you have in that?

Amyas Morse: I will answer that in two ways. First of all, our financial audit guidance sets out certain categories of accounts that have to be described consistently, and there have to be consistent accounting policies. So we are not talking about that. What we are talking about is more the subject of comparative figures of performance. My view on that is that, yes, you are quite right that the less comparable and the less consistent the information is, the lower its quality. However, having said that, it always costs money to have information at very high levels of quality. We have found that at PAC, with the studies we have done on openness of information, where we have said, “If you want to have very high quality information, please be aware that it comes at a cost.” You have to be constantly improving the data—censusing that and so forth—if it is going to be at that level. So whoever produces it, if you are going to have very high quality comparative information it will cost money. The question is just what level of precision would be needed in order to provide meaningful comparisons between authorities or bodies that may or may not be fully comparable. It may be that what you need is at quite a high level. We would be happy to have that discussion in our relationship with the LGA; if they ask us, we would be happy to advise them.

Q599 Meg Hillier: But with all those sectors—the LGA, health, the police and so on—do you think the NAO has a role in making sure that that data are collected at that level?

Amyas Morse: No, I don’t.

Q600 Mark Reckless: Do you think that HMIC should have a statutory veto power over NAO activity in the policing arena?

Amyas Morse: I am sorry, but I have not even considered that. I wish I had listened to the testimony. No, I don’t.

Mark Reckless: To recap briefly, Tom Winsor, who has of course been recently appointed, referred to what he described as a general veto power. He had a long list of bodies, I think including the NAO, where he would veto activity.

Chair: And the Audit Commission was in there.

Q601 Mark Reckless: My understanding was that this veto power had been brought in when the Audit Commission extended its empire to policing in 1996, because of concerns about the Audit Commission. However, I think he was suggesting that he would want a general power to veto activity by any other regulator, including the NAO, if he felt it was going to be duplicatory.

Amyas Morse: Let me be clear: I am not a regulator. I would not be trying to compete in regulation at all.

Q602 Mark Reckless: He also said he was not a regulator.

Amyas Morse: All I would be doing is looking at value for money. The note that I have been passed says “Definitely push back on this”: how fortunate that it confirms what I am already intending to do. Thank you for that; we work as a seamless team.

My view is that they just need to relax a bit and assume that if someone is examining them on the basis of evidence, as we do, that will not be prejudicial. Shining light on issues of productivity, efficiency and effectiveness are not, in my view, likely to be damaging activities. I really cannot buy that as a general proposition. Therefore, the idea that it was possible for every audit examination or value for money examination that might be made to be subject to satisfying someone that they think that that is okay is very limiting. Should we be asked to do it, I would not be in favour of that.

Q603 Mark Reckless: But are there not legitimate concerns, particularly in the field of policing, that there are a lot of different bodies—they regulators or otherwise—who can in and examine what they are up to and make recommendations?

Amyas Morse: To be honest, this is part and parcel of my everyday work. I go to Departments and arm’s length bodies to propose a study, and they might have a good reason why it is not right to do it at the time. First we think about that; then we discuss what we are going to do; then when we have the findings, we meet them—we are happy to meet them several times—to talk about whether our findings and facts are fair; and only then do we publish a Report.

So we go through a pretty extensive clearance process to be sure that we do not have arguments, although we do have arguments, about facts in front of the PAC. We are accustomed to operating in a way that is quite meticulous, as regards taking account of those who are being examined, to make sure that the facts we record are accurate?

Q604 Mark Reckless: To what extent would the NAO expect to expand or otherwise its role in the policing arena, if I can ask specifically about that?

Amyas Morse: We have done work in the policing arena. We have done work on a number of initiatives that were accessible to us in the policing arena, and we have done it in exactly the same way—by and with considerable consultation and full clearance.

Q605 Mark Reckless: Will there be more or less of that in future do you believe?
Amyas Morse: That depends if we are invited to do the work, if we are, there will clearly be more of it, but it will all be done in the same way. We have no interest in having a dogfight in front of any Committee or otherwise about whether the facts on which we have based our judgments are inaccurate. We want to have accurate facts and to make a judgment that is likely to be persuasive to the audited body to do things differently and improve, if possible, its efficiency and effectiveness. That is our goal.

Q606 Mr Betts: You said “if we are invited”. Should you have the power to do it if you want to do it, as opposed to having to be invited?

Amyas Morse: I would like to have the power to do it if I want to.

Q607 Mr Betts: For both health and police?

Amyas Morse: Yes.

Q608 Mark Reckless: You used the phrase “efficiency and effectiveness” in respect of policing.

Amyas Morse: That is part of my statutory charge.

Q609 Mark Reckless: But is it not specifically the statutory duty of HMIC in respect of policing?

Amyas Morse: I will not see my efficiency and effectiveness as being on policing practices—obviously not, as I am not an expert in that area.

Q610 Ian Swales: On the question about the independence of auditors, there was a nuance from the previous witness that I must admit I had not picked up. That is that in the policing area—I do not how many other areas this belongs to—the audit panel has an advisory power in terms of the police and crime commissioner, rather than the power of appointment. Does that concern you, and do you have any other concerns about the appointment process, the independence of auditors and whether that needs tightening up?

Amyas Morse: There are a number of choices about the precise method of appointment, but to be really credible it must always contain an element of clear, demonstrable independence, both in terms of the membership of such a body and in terms of process. As I indicated earlier, I think you could have a panel if that is acceptable and you could have the audit committee, as I suggested the Government should consider, but in each case you have to have clarity about the fact that the appointment is without fear or favour.

Q611 Ian Swales: As so often, you have to test these things by imagining their going wrong. Let us just suppose that in a police authority there was a cosy arrangement about who was on the audit panel, and that even then the police and crime commissioner failed to take its recommendation and appointed somebody that they just fancied appointing, or fired the previous auditors because they were getting too close to some problems. What is the route by which we ought to ensure that that kind of thing does not happen? I know there is the whole democratic bit behind that, but what should happen organisationally to ensure that we do not get into those problems?

Amyas Morse: There is a difficulty in that there are jurisdictional limitations, but it is possible to see a general principle there that you espouse. Then you look at where it does not seem to be being met and progressively campaign to get that principle adopted. Talking practical politics, that is what I think.

Q612 Ian Swales: But we are looking at a Bill here. Is there something we can write into it?

Amyas Morse: Yes, there may well be.

Q613 Mr Betts: In terms of the authorities that might get into difficulties of whatever kind, whether simply through bad management arrangements or financial difficulties, currently the Audit Commission will largely be the body that picks that up and flags it to the Secretary of State. The Secretary of State has powers under the Bill to intervene as a last resort. How far will the work that you do in looking at value for money and other studies across local authorities potentially provide evidence that you would be able to use to flag up to the Secretary of State difficulties that are occurring in particular authorities?

Amyas Morse: If it is sufficiently serious to be picked up in our study, we will liaise with the Department. Therefore, it will have knowledge of our findings.

Q614 Mr Betts: So there is a direct link: if you find something, you pass it on?

Amyas Morse: Yes.

Q615 Mr Betts: Just to come on to the other examples, because we always talk about them in these cases, let us address the Westminster case. Unfortunately, the public interest report on Westminster was a very high profile and unusual case, and it has not been replicated elsewhere in quite that form, but you are always going to have procedures in place to ensure that if it does happen again it can be properly dealt with. In that case, it was not simply the auditor who pursued it; the auditor was very much supported, backed and underwritten by the Audit Commission. How would public interest operate in a similar situation under the Bill with no Audit Commission to back up the auditor?

Amyas Morse: I would like to say that we could support it, and if it is possible, we would.

Q616 Mr Betts: Would you need a power to do that specifically?

Amyas Morse: There is just one comment I would make—

Q617 Chair: What are you being told to say?

Amyas Morse: No, it is in my notes already. I was simply going to say this: at the moment, one way in which the Audit Commission supports public interest reporting is by giving indemnity to the auditors. When it does that, it is really only giving the indemnity of the Government. It is not only doing that, but it is effectively giving indemnity on behalf of the sponsoring Department. On a comparable basis, the indemnity in my view should be given by DCLG.
Q618 Mr Bacon: And not by the independent National Audit Office?
Amyas Morse: No.

Q619 Mr Betts: Does that mean that DCLG has to have people who can look at the issue and take that decision?
Amyas Morse: If I was giving indemnity, I would expect to be told when such an indemnity was likely to be called.

Q620 Chair: I have to say hang on to that for a minute. That is an interesting idea, and I want to explore it a little. This is an auditor going in and saying, as they did in Westminster, “There is misuse of public money.” It is very difficult to get a Department that does not have auditing skills—it has lots of other skills—to agree to indemnify. 
Amyas Morse: I do not think so. This is not really a question of auditing skills; it is a question of insurance, if I can put it that way. Take the Westminster case, if you like. That turned out to be a case with enormous costs and an enormous amount of activity. If you said to auditors, “I want you to take that yourself, and good luck with it,” they would naturally want to know whether they would be indemnified in the event that they took it. The Department can perfectly well give that indemnity.

Q621 Mr Betts: But the Department would then be giving a blank cheque to every auditor.
Amyas Morse: No, it does not have to be a blank cheque. You can put together an indemnity that is intelligent.

Q622 Mr Betts: Where does the intelligence come from? I suggest that that intelligence might come from yourselves.
Amyas Morse: That is possible.

Q623 Mr Betts: So it could well be underwritten by the Department, but on advice from the National Audit Office?
Amyas Morse: Yes, that is possible. I would not have any fundamental objection to that.

Q624 Mr Betts: Would you need the power to do that?
Amyas Morse: Pass. I do not know the answer to that.

Q625 Mr Betts: I think you are getting a nod from behind.
Amyas Morse: All right. Excellent. That is good. Obviously the answer is yes.

Q626 Chair: If we go back a little while, you said that a lot of this depends on how it’s going to be implemented, and I think that’s true. What we are trying to do is belt and brace it a bit in the legislation, so that not too much is left to chance. One of the things you talked about was the importance of DCLG being an intelligent eye on what is happening in local government, to be able to intervene there. We are seeing the Secretary of State after you, but I am not sure that that is his take on it. If it isn’t, how do you think that his permanent secretary, as accounting officer, will be able to sign off the accounts to your satisfaction, in terms of accounting officer responsibility for the expenditure authorised through that Department?

Amyas Morse: The accounting officer, at the moment, to the extent that he takes assurance from auditors in local government, obtains assurance from them, and that is part of the assurance he gets. In some part they are private sector, reporting to the Audit Commission, but he will receive that assurance from local government, supported by audit opinions, and that will enable him to rely on the report. I am sorry; I am probably not saying that clearly enough, but it is a pretty straightforward process. What is in the accounts of local government is assured by the auditor.

Q627 Chair: So he will have to have a capability won’t he, which presumably the Audit Commission currently has, to do a little tick against the audits of all the local authorities and other bodies?
Amyas Morse: He doesn’t have to assess, he simply relies on them. He simply gets told that they are cleared audit reports and that he can place reliance on them. I don’t think that requires great expertise.

Q628 Chair: And that’s enough is it?
Amyas Morse: Yes it is.

Q629 Mark Pawsey: I am just looking at the evidence you gave to the CLG Committee 18 months ago, when you said that you were fascinated by trying to improve the efficiency of what happens in the public sector. With the passage of time, are you any more confident that we can continue to improve the efficiency of what happens in the public sector?
Amyas Morse: I am not only fascinated, I am passionate about it, and I think we have achieved a lot in the past 18 months; there is a lot more to achieve. I give an example alongside what we are talking about, which is making sure that the contracting out of services works to deliver full public value. We have a role to play in helping to drive that, so that it doesn’t happen against contracting out, but we make sure that Departments and those who are receiving a service really receive the full value they should receive.

Q630 Mark Pawsey: But are you more positive about the effect of the changes now than you were then? Have you still got reservations?
Amyas Morse: What I am very clear about is that we do effect change, yes. The Public Accounts Committee effects change and the National Audit Office effects change. I am sometimes surprised by the effect we have, but we clearly do have a significant effect.

Q631 Mark Pawsey: But I am asking you about the move with what has happened over the past 18 months, now that we know more and things are working themselves up. Are you more confident about the ability to do that, and to do it more effectively, or are we in the same place, or less well-off?
Amyas Morse: I think I am more confident because I am more confident about my ability and the ability of
the PAC to combine to have a considerable improving effect, because I have seen it happen.

Q632 Chair: I have one very final question because we have the Secretary of State outside. Where should the national fraud initiative be housed?
Amyas Morse: Well, not with us. I am a strong supporter of the national fraud initiative—let me be very clear, on the record—however, I see the control of fraud as an executive function and not the function of an independent auditor. Although I am supportive and I wish it well and want to see it in a good place, I don’t think the place is with us, for that reason.
Chair: Good. Thank you very much indeed.

Examination of Witnesses

Witnesses: Right Hon Eric Pickles MP, Secretary of State for Communities and Local Government, and Amyas Morse, Parliamentary Under-Secretary of State, Department for Communities and Local Government, gave evidence.

Q633 Chair: Welcome, and thank you. You are our last witnesses before we write our report, so we have saved the best till last. No doubt you will have been told about some of the issues that have been raised during our consideration of the Bill. We very much see our role as looking at the legislation you have placed before us, and seeing whether there are gaps and risks, so we have kept ourselves very much focused on that task.
Eric Pickles: It is entirely your fault, because you were so persuasive in getting me to do it this way. Otherwise, I might have—
Chair: I hope we will get a better Bill out of it.
Eric Pickles: I am sure we will.

Q634 Chair: Let me start by asking you some questions that everybody has raised, on auditor appointment. I do not think you have had any support from any of our witnesses for the proposals on independent audit panels in the draft legislation. We have had a number of alternative suggestions, but people find that they are an unnecessary layer of bureaucracy, that it will be difficult to fill the panels, that they will not necessarily add value, and that they will not deal with some of the problems that will arise out of potential costs of procurement by the localisation of auditor appointment. I wondered whether you had reflected on the proposals since they were included in the draft Bill, and whether you had any thoughts on that at all.
Eric Pickles: I have. I am afraid I cannot be helpful in winding up controversy, because I thought that a number of the points made were entirely reasonable. There are a number of solutions. I notice that small authorities have looked at creating a set by which they would do the appointments, so we would have a number of independent people to do that. I see some suggestion that some of the larger authorities are thinking in those ways. I have seen some suggestions that authorities could merge together—go out together to find these independent persons. I thought that the points made were entirely reasonable. I looked, in terms of what you would like to recommend, but again, I hope I do not sound—

Q635 Chair: You are open to ideas. I am less close to the local government scene than Clive Betts and Mark Pawsey are, as members of the Communities and Local Government Committee, but what was of interest to me was that probably the most favoured solution was a small, central capacity to carry on taking advantage of the economies of scale and eking out best value from the private auditors by bulk purchasing.

Q636 Chair: Good. Well, it looks as if our recommendations might in some little way improve the Bill. Let me ask you something else. We have just had a discussion with the NAO, and Amyas Morse took the view that if this is to work, there still has to be intelligent and strong vigilance by the Department on the audits of individual local authorities. I wondered what your view was. I know you very much want to decentralise and localise it all. What I heard from him was in the interest of your permanent secretary as accounting officer to us at the PAC, down the line, and you are interested in ensuring value for money. There has to be a stronger capability within DCLG, to Brandon Lewis, and from Brandon to you, to satisfy the public and satisfy Parliament that there is both probity and value.
Eric Pickles: Obviously, I have not had the advantage of hearing the CAG’s evidence, and I will clearly look at it carefully. In the Bill, it is envisaged that it is going to be put together by trying to ensure that you have roughly the same kind of regime, both in company auditing and in public auditing. Clearly, we look to the National Audit Office to put together a code of audit practice, but we look to the Financial Reporting Council, plus the professional bodies, to ensure the ethics and the like.

Q637 Chair: What role do you see CLG playing to satisfy you about the accounting office role?
Eric Pickles: Very much one of last resort.

Q638 Chair: Assuring Parliament that money has been properly spent, and that value for money is
Q639 Chair: There isn’t a district auditor, is there?
Eric Pickles: I beg your pardon. Old habits die hard. In terms of dealing with audit generally, if there was a problem, it would be very much like things are being dealt with now. For example, the Audit Commission did not play a very significant role in dealing with the problems in Doncaster, but the LGA did.

Q640 Chair: Let us take the Westminster example. I am not trying to be partisan, but in that instance the auditor did play a very important role. One has to always look at the exceptions to make sure that the framework is right. In that instance, if my memory serves me right, about £2 million of fees were spent in looking at certain aspects of the housing policies in Westminster. That was underwritten by the Audit Commission. In the new world—I just want to put this to you because you will not have heard it—the NAO came forward with a rather sensible suggestion, I thought, which was that the underwriting could lie with your Department on the advice of the NAO.
Eric Pickles: Forgive me, Mrs Hodge, for suggesting that you might be mildly confused—I hesitate to say that. The problem, if you will recall, in Westminster was not the audit fees, which were paid without any problem. It related to the court fees and the surcharge. That was where the big controversy lay. The only circumstances where that would take place would be if a private individual took the auditor to court. There is no instance, and I have looked into this—

Q641 Chair: I am not up to date so I may have this wrong, but surely if the auditor of a local authority decided to do a report in the public interest, which then led the auditor to take action in court—I accept that a lot of the fees are racked up during the court process—that would all be underwritten by the Audit Commission. If we do not have the Audit Commission, somebody has to underwrite the auditor in taking appropriate action.
Eric Pickles: I am pretty certain that I am correct, because I have looked into all 14 public interest cases. In every single one, the audit fees were paid. There were special and unusual circumstances in the Westminster case and the pursuit of Shirley Porter, but that did relate to the surcharge.

Q642 Chair: But that was underwritten by the Audit Commission. The risk on the costs of pursuing the council was underwritten by the Audit Commission.
Eric Pickles: I think what I am really saying is that I cannot imagine circumstances where Westminster would be repeated, because clearly the surcharge has now gone. But if there were particular circumstances that the Committee might think—there might be some circumstances where the auditor might not get their fees—I would be very willing to look carefully at that.

Q643 Mr Betts: As a follow-up, in the end, it is important that the auditor’s costs are provided for in some form. There has to be a clear understanding that there is a mechanism for that to happen in all circumstances.
Eric Pickles: There is no problem at all with the audit fees.

Q644 Mr Betts: Extra costs that come from public interest reports.
Eric Pickles: I am not convinced that the Bill does not cover that.

Q645 Mr Betts: We have to make sure that it does one way or another.
Eric Pickles: Mr Betts and Mrs Hodge, you are very reasonable people and have enormous expertise on that. I shall get my very clever people either to prove you wrong or to issue a grovelling apology.

Q646 Mr Betts: There is a slight additional point on the role that the Audit Commission played in that particular circumstance. They gave advice and reassurance to an auditor who was a bit out there on their own in a very high-profile case. I just wonder whether there is some necessity for some fall-back power for the National Audit Office to be able to exercise that sort of role and give guidance and advice to an auditor in a very difficult case such as that one were it to be repeated.
Eric Pickles: Of course the auditor would be able to rely on the professional accounting bodies and on the Financial Reporting Council, so I am not entirely clear why that would be necessary. The idea is to make the auditing of companies and of public bodies roughly the same in the way in which auditors look to such bodies for guidance and support. If you have particular circumstances in mind, Mr Betts, I am very happy to explore it.

Q647 Mr Betts: The fact is that the accounting of public bodies is not the same, because public interest reports do not happen in the private sector because they are public interest reports and the scope of audit is different. The professional bodies and the FRC have a role in the private sector, but there is a difference here in public sector audit.
Eric Pickles: Public interest is a very rare thing. In the past 11 years, there have been 14 cases, and they have varied enormously in terms of the reasons for doing so.
Mr Betts: Being prepared for the unexpected is quite a helpful thing to do sometimes.

Q648 Ian Swales: As the Chair said earlier, part of this is testing against those cases to see whether the Bill is robust and whether the arrangements are robust. My local police force has run up a bill of £4 million and still counting on an investigation, which is way beyond their own ability to pay. You talk about the parallel with the private sector. Do you therefore see some kind of Serious Fraud Office-type arrangement? If things get to the point where there is a massive case, that would be the parallel. Is that what we need to talk about? What would the fall-back be in terms
of how work would be done and how it would be paid for?

**Eric Pickles**: I am not entirely sure of the circumstances where that would occur. I can go back 30 years from personal memory, and we are talking about one case and that was a serious aberration and a serious breakdown of responsibility and trust. In terms of public interest reports, these are immensely rare and very unusual. Of course, with greater openness making sure that local authorities produce the documentation and the raw audit, they are now more subject to freedom of information requests. That was not available in Westminster. There is a provision in the Bill, before the final audit is done, for members of the public to see the raw figures and the documentation 20 days before it is commenced. There are all kinds of checks and balances within the system.

**Brandon Lewis**: One other thing we need to bear in mind is that we are in a very different world in terms of the information that is out there, where it is accessible and how it is accessible in the first place, compared to when we were looking at Westminster—your example. As we have seen recently in the Isle of Wight and Barnet, with the internet and accessibility through transparency, the general public—bloggers, journalists and so on—can very quickly access information that simply was not available back then. There is a whole other layer. In some ways, I suspect, as we go forward in years, it is going to become a far more intrinsic way in which authorities are held to account. The public will be doing it. They will not be able to hide things in the way that—

**Eric Pickles**: You raise a very interesting point. I am talking completely off piste now, but if you think about it, I do not think the Westminster scandal would have got to anything like the position that it did if the present arrangements with regard to transparency and freedom of information had existed. It would have saved our local government a horrible scandal, and probably saved Shirley Porter quite a lot of money.

**Chair**: I hear that. There is some truth in it. I want Ian to talk about his police example, but the interesting thing about Westminster was that it was an individual ratepayer who took it forward. But the ratepayer does not have the apparatus and resources to pursue a council if they think the council has acted inappropriately. The ratepayer “whistleblew”—in today’s terminology—to the auditor, and then the auditor, who does have the resources, took it forward. I hope it never happens, but all we are saying is that, responsibly, in drafting the legislation, there ought to be a system in place allowing that process to happen unconstrained by somebody thinking, “Who’s going to pay for this lot?”, in the interests of proper accountability, value for money and probity.

**Brandon Lewis**: I cannot see circumstances in which an auditor would not get their costs, but—

**Chair**: They have to risk it. I think there might be a difference of view. We will never know the answer, but risking £2 million in the early 1990s was a lot. It was very helpful to the whole process to have that indemnified by the Audit Commission.

**Eric Pickles**: Any indemnity issued is also not going to be paid out immediately. There will always be a test for reasonableness. I say this with enormous respect: I do not think that so far you have made a case for this to be in the Bill, but I will consider it. I want to go about this on a completely consensus basis. Of course we will look at anything.

**Q651 Ian Swales**: Just expanding that, clearly the focus of your attention and the Bill, understandably, is local government, but of course, the Audit Commission goes into other areas. We heard evidence this morning from the police. Maybe you are the wrong person to answer this, but I think it is worth exploring with you the effects of the Bill in other areas.

If we take my own police force, in an interesting bit of symmetry, the previous chair of the police authority was prosecuted for perverting the course of justice on the very day of the police commissioner elections. We now have a new police commissioner, who walked in on his first day and sacked the chief executive of the police force and put someone he was familiar with into the job. That shows behaviour where there ought to be some checks and balances.

In the evidence earlier today, something became clear to me that had not been clear so far, which was that even the independent panel has the power only to recommend an auditor to the police commissioner under the new arrangements. There is a real concern about the extent to which the new arrangements will have the checks and balances that we want to see in the public interest.

**Brandon Lewis**: Obviously, the police commissioners come within the remit of the Home Office—the Department of Health has fed its own things through to the Bill—and that is something that we need to take back to the Home Office and talk to the Home Secretary about.

**Q652 Ian Swales**: You are the lead Department on the Bill. Have you checked that the arrangements work in areas outside local government, such as the police? Have you been formally liaising with your colleagues, because the Audit Commission goes into other areas?

**Brandon Lewis**: You have given a specific example there. Rather than give you an instant response, I would rather have a look at that and come back to you with a proper response that answers the question.

**Chair**: It is a pretty shocking example.

**Brandon Lewis**: With the greatest respect, I want to find out more about it before I come back with an off-the-cuff response.

**Q653 Ian Swales**: To be fair, I am not looking for specific instant feedback; what I am saying is that the arrangement we are putting in place needs stress testing against real-life situations. Sometimes we get surprises because there is something that we never thought of. If we have got real cases like that already, we need to stress test the arrangements against how they will work.

**Brandon Lewis**: I appreciate that. It is part of the advantage of this Committee and what will feel
through from it, but that is why I want to look at what has happened in that case and get some more detail before responding. I want to make sure of the facts. Obviously, that is something that we will talk to the Home Office and Home Secretary about.

**Eric Pickles:** You certainly seem to have an exciting police authority.

**Ian Swales:** It is a bit of a legend at the moment. The first force to sack its chief constable in about 30 years, I think. That happened two months ago. It is quite exciting.

**Q654 Chair:** I wanted to bring us back to the more general, rather than the specific. We had succinct evidence from Lord Heseltine last week, and he was completely clear—I don’t know whether you had a chance to read it—that we needed a systematic process and common methodology to allow value for money in like-for-like services across local authorities to provide incentives to improve. That is very obvious. Do you agree with that?

**Eric Pickles:** The one moment of hesitation that I had in this process was realising that I was tearing up Lord Heseltine’s noble work.

**Chair:** Against us.

**Eric Pickles:** It is the strangest thing. The reason why I took the decision was, while the Audit Commission was completely independent when it was set up—it would not even talk to Ministers, if you remember, when it first started out—it gradually went from that process of haughty good practice, saying “This is the way to do it”, to becoming an enforcement arm of Government. I felt that it had completely lost its way. I wanted to preserve the integrity of the audit process, recognising that things have moved on, but also recognising that, in a way, the Audit Commission had almost become a parody of itself in terms of wastefulness and lack of regard for the public purse. If we are honest, it was not terribly effective on the big issues that affected local government. I think that you saw some evidence of that from other witnesses. In doing that, one of the first people that I told that this was where I was going was Michael Heseltine. It was not an easy meeting, but he kind of understood that I was going to do it. However, I then had the misfortune of telling him that I was also winding up regional government. I still get a Christmas card from him.

**Q655 Chair:** That is a very neat answer, but you have not actually addressed the issue of value of money. What your system does is the audit. I can understand that. But he was absolutely clear: he said that you have to have a framework and you must be able to prepare the data. You have to have value for money if only—again—for you to provide assurance to Parliament that you are spending the taxpayers’ money properly, and, certainly for my Committee, to make some effort in proving value for money.

**Eric Pickles:** I agree, but I do not think that value for money can always come from the centre. As you devote power to local authorities, that value for money has to come through local accountability and local activism. It is right, of course, that there should be a commonality to be able to compare local authorities, and the Local Government Inform is an important arm of doing exactly that. But I am not entirely sure that the Audit Commission—I say this with lots of respect—really added to that process of producing value for money.

**Q656 Chair:** In a sense, put the Audit Commission and its record to one side. The Public Accounts Committee would feel very strongly—a lot of money comes through your Department—and we would want to know whether there was value for money received for the taxpayer. Following the taxpayers’ pound—rather boringly, I say that all the time—we would expect to be able to interrogate reports that gave us comparative data, from dustbin collection through to housing management or whatever.

**Eric Pickles:** Dustbin collection—yes, I agree.

**Chair:** Or whatever. It does not really matter.

**Eric Pickles:** The National Audit Office will have the ability to produce that. In addition to which, I do not think we should be snifty about this. There will be the Institute for Public Policy Research, NESTA and various academic bodies.

**Q657 Chair:** But they need the data.

**Brandon Lewis:** This comes back to the point I made earlier. This is one of the really big changes in where we are. That data is there for anybody, because of the transparency agenda. Also, you have to remember that 95% of local authorities are signed up to LG Inform now, so that information is out there.

**Q658 Ian Swales:** There is data, information, knowledge and wisdom. Dumping a whole lot of data—mountains of data—out there is good from a transparency point of view. The armchair auditors, as they are called, would also quite like some information, and this is the type of thing we are talking about—in other words, aggregations that show comparisons and so on. Knowledge, if you like, comes from knowing how my authority is doing against another. That is what we are talking about here.

**Eric Pickles:** In terms of “one I made earlier”, this is a list of the data that is currently collected up to that point that is available through the Local Government Inform process. Things have kind of moved on since those days when information was not available. Taxpayers will be able to do a compare of those things. Newspapers will be able to do a compare. Mr Swales, you will be able to do a compare. It is not about Mr Betts shaking his hands. You did get pretty good evidence to say that some of the stuff that was coming out of the Audit Commission was excessive and unnecessary, and there needs to be a check. Mr Travers—before Mr Betts—drilled me to the floor on all this unnecessary data that was collected and how we must have an agreement. We now have an agreement between local and central Government as to the data set. If we want anything excessive, we have to pay for it. That seems to be a sensible thing. You cannot have your cake and eat it. You cannot say we are asking for too much money. We should have an agreement with regard to the data set that we keep.
Q659 Mr Betts: Coming on to that, a lot of it out there is in very raw form and it is not usable by people who want to draw comparisons. It is not about transparency. It is not usable in the way that you draw comparisons about value for money. Do you believe that the six studies a year by the National Audit Office are going to be sufficient? No, you probably do not, because you have already talked about the Local Government Inform scheme, which, although I am very supportive of it, is still being developed and not there yet. Does it not need some statutory underpinning to ensure that all authorities get involved, because 95% are? The 5% that are not, perhaps some of them will join, but some authorities are not even members of the LGA.

Eric Pickles: But the information includes all authorities, whether they are a member of the scheme or not.

Q660 Mr Betts: Should we be allowing free riders then?

Eric Pickles: That is a matter for the Local Government Association to work out. You do not expect me to put in a statutory underpinning for the Local Government Association fees, do you?

Q661 Mr Betts: I am just asking whether there needs to be some more statutory underpinning of the process of value for money and the data needed to provide for that.

Brandon Lewis: But there is, in the sense that that is a duty of the councils and their chief financial officers, as well being what the councils get elected for in the first place. So, to an extent, that is already there.

Q662 Mr Betts: Except they can still opt out of it.

Brandon Lewis: No. A chief financial officer is nothing to do with LG Inform. That duty to deliver value for money for taxpayers is inherent in being a councillor and a chief financial officer in a local authority.

Q663 Mr Bacon: Isn’t there also statutory underpinning in the Bill in clause 94, which says: “The Comptroller and Auditor General may carry out examinations into the economy, efficiency and effectiveness with which English local authorities have used their resources in discharging their functions.” Granted he must have regard to various things and consult various people, but even if he decides for perhaps very good reasons to restrict himself to six large national studies, that is statutory underpinning, is it not?

Eric Pickles: Mr Bacon, you are absolutely correct, but I was seeking to avoid mentioning that on the grounds of decency, because you might say, “Yet another power taken by the Secretary of State.” I do regard myself as long stop on this—of course I am. If things look particularly whacky in an authority, then of course we will look to intervene and to demand intervention. I was urged by people in this room to move towards a system whereby we worked with local government on the basis of consensus, and that is what I am trying to do in terms of the data set, of the reporting and of making sure that reports are relevant.

Q664 Chair: If I can draw on this little conversation slightly, we all agree about the transparency. I think, Secretary of State, that you do agree that you need to have comparability—the NAO will do its four, five or six reports. I am clear—do you agree?—that that has to be on the basis of the Comptroller and Auditor General being able to compare the data. So whether it is less data, which is what I understand the CLG Committee wanted, or whatever, as long as we are in the same place in understanding that there have to be data sets that allow a comparison to be made, so that value for money can be assessed, you can assure yourself that money is properly spent and local taxpayers can assure themselves that their local authority is value for money.

Eric Pickles: That is right, but I also have to guard local authorities from gratuitous information. That is why there is a kind of yearly round at which we agree the data that we will want from local authorities, and to guard them against someone bright in my Department suddenly thinking, “Well, it would be absolutely magnificent if we had the information on the colour of dustbins.”

Mr Betts: Have you got a view on that as well?

Q665 Chair: I am moving us on. Do you think that the LGA should tell the NAO what reports it should do?

Eric Pickles: I would be really pleased if there was a kind of agreement in terms of where we are looking at things, but you have always got to ensure that the National Audit Office has the ability to say, “No, no, I want to do that.” That is right; it should always be able to do that, but sometimes—with a lot of things that I have been trying to do—I have really tried to get a degree of consensus to look at areas that we have all known we need to do. A prime example of that would be troubled families, whereby we have announced an initiative, but we could not really have got it off the ground had there not been consensus right across local government that, actually, this was an area that everyone had neglected for a while.

Q666 Chair: Another area that has come up in our evidence has been the national fraud initiative, which everyone thinks is a good thing but has yet to find a home?

Eric Pickles: It is indeed, and we will indeed find it a happy home, and any recommendations that you may care to make—clearly, it will probably go into DWP, the Home Office or the Cabinet Office. But it is a valued initiative.

Q667 Mr Bacon: You will agree with the CAG’s comment, which you may not have heard, that he regarded the NFL, which he strongly supports, as an executive function, and that therefore the NAO would be an inappropriate home for it.

Eric Pickles: I have never in my wildest dreams thought it should come to the NAO, so he can rest safer in his bed tonight.
Q668 Chair: Okay. So we will make a recommendation to you, but you are aware of it and you will take it up.

Eric Pickles: Yes, absolutely.

Q669 Mr Betts: You interrupted my holiday in August 2010 with your announcement, I think, that you were going to save £50 million as a result of the abolition of the Audit Commission. It has now gone to £650 million over five years. Presumably, quite an element of that is the extraneous things that the Audit Commission has developed over the years, or been given, like the comprehensive area agreements or CAAs. In terms of the actual audit function, what saving do you now expect to get as a result of the abolition of the commission?

Eric Pickles: Of course there is a billion and a bit over a slightly longer period. If I could refer, Mr Betts, to page 171, that lays out the various savings. There are basically three biggish things. We are talking roughly about the sums, but there is about £20 million1 in ending the inspection; there is about £264 million that relates to the cost of audit; and there is about £225 million on overheads and ending payments to contractors. That is what the £650 million is roughly made up of, but a breakdown is available there.

Q670 Mr Betts: I am sure that we will have a look at that before our final report. About the £650 million, how much of that was a saving related to where the Audit Commission was in 2010 and what would the saving be compared with what the Audit Commission does now?

Eric Pickles: I don’t think you can divide the two.

Q671 Mr Betts: I think you can, because—

Eric Pickles: I’ve kind of heard your evidence, in which people say, “Oh, look, we’ve done this; we’ve done that; these savings are made; we don’t need to do it.” The fact is this, Mr Betts: none of these savings were made until we took the decision to abolish the Audit Commission. And I was pretty surprised, I have to say, about the extent to which local authorities had been overcharged for their audit function. If we don’t ignore what they were actually doing, if we don’t ignore the total size of the Audit Commission, if we then pretend that they have moved down this road of their own accord, then of course—but there are still savings to be made.

Q672 Mr Betts: I wouldn’t want to take any credit away from the action you have taken so far, but let’s say we are where we’re at. The Audit Commission is now running in a very different form, doing far less. We are getting strong advice from our officers we should do, because that would keep the Audit Commission happy and because of driving up recycling. From memory, we managed to drive up recycling from just below 20% to just over 40% and doing it in our own way, where we can make it easier for people. I will not take up the Committee’s time in going through the exact details of how we did that.

Brandon Lewis: But for local authorities that are interested, we looked at how to make it easy for people to recycle. Instead of saying that you must do this and we will stop having a weekly collection, we made it as easy as possible. We gave out free bags and we sorted out a base that was more cost-effective. Because it was easy, more and more people were recycling. [Interruption.] I did not want to move too far away, but Mr Bacon invited me to do so. My point was that we as a local authority spent quite a lot of time, and officer time, researching going down the road of fortnightly collections. That was not because any of our members wanted to do it, not because any of our public and our residents had asked us to do it, but because our officers felt that we should do it as it would keep the Audit Commission happy. If we did not keep them happy, there would be other connotations. That used to happen quite regularly. It could be that or preparing for CAA or the time taken with that—

Q673 Mr Betts: We have already established that CAA has gone anyway.

Brandon Lewis: I appreciate that. All of that time and effort in officer time was a huge amount of money. My chief executive said to me that he thought that we were probably using the equivalent of at least one, and arguably two, senior officers’ salaries a year to satisfy what we would refer to as the tick-box culture to keep the Audit Commission happy. For a small local authority with a budget of under £10 million a year to be spending arguably £100,000 or £200,000 a year on that kind of thing is not a good use of taxpayers’ money. Such savings are difficult to quantify, but for the sector, that is 3% or 4% on your council tax. A council leader said to me this week that they believe that the cost of the Audit Commission to them, outside
of the audit where they are delighted to have saved around 40% because of the reducing fees, was around 2% on the council tax. That cannot be good for residents.

Q674 Mr Betts: I am asking about the savings from where we are now, not from where we were.
Brandon Lewis: But it still applies. The spectre of the Audit Commission on your back as a local authority—that needs a clean break as much as anything else psychologically.

Q675 Mr Betts: One thing that has been said to us by a number of witnesses is that they do not believe that fees will go down and that there will be additional costs of procurement with each body doing the procurement themselves. In particular, while large authorities, such as Birmingham, which had the chief executive before us, thought that they might make some savings on audit fees, the concern was that smaller authorities, such as the one you mentioned, will actually pay more in fees once they start procuring individually.
Eric Pickles: Yes, but Birmingham also went on to say that they were more than willing to band together to get some of the advantages—to get a critical mass in terms of getting fees together. I have just noticed from the copious briefing notes that I have some figures for income from audit fees paid by local bodies. If we start at 2009, that is £175 million. That drops in 2015 to £81 million and drops to £74 million by 2017. The corporate cost of the commission reduces from £48 million down to £9 million. So against that bid, it is a bit different to say, “Ah, but ignore the drop from £48 million to £9 million.”
Mr Betts: It has gone.
Eric Pickles: Yes, but you cannot ignore it. You cannot say in an ideal world it will be very different. These things have happened.

Q676 Mr Betts: The ideal world is the here and now, Secretary of State. It is a comparison with the here and now. The figures that you have offered to provide to us about savings from the here and now would be helpful. Perhaps when those savings figures appear from the Department, it will be helpful to make sure they have added in the additional cost for the NAO, the FRC and anyone else who takes on additional responsibility as a result of the Audit Commission being removed. That surely is a fair way to present them, is it not?
Eric Pickles: Even the Audit Commission, bless their hearts, say they do not disagree with the £165 million figure.

Q677 Mr Betts: But you yourself have questioned the effectiveness of the Audit Commission, Secretary of State.
Eric Pickles: That remark is unworthy of a statesman such as yourself.

Q678 Chair: The PAC does its business in an entirely different way. I was going to ask a more general question arising out of that. There are some audit contracts that are going to be outstanding—about £90 million of awarded contracts. Witnesses have raised with us the issue of how those will be managed.
Eric Pickles: That is a fair and reasonable point. We will determine who will take care of and administer them. It could be the Department; it could even be the sector. I am completely open to suggestions. If the Committee thinks of an appropriate body that could look after them, I am more than willing to listen. But obviously, that question needs to be addressed for that vital period.

Q679 Ian Swales: A quick point. We know that a key part of the control structure of any body is the ability of whistleblowers to know what to do. The Bill is quite light on whistleblowing. Presumably you want that activity to continue. I am wondering if you think there is anything that needs to be beefed up in the Bill as regards whom whistleblowers go to, how they might be protected and so on. It is not going to be as straightforward in the new regime as it possibly is now.
Eric Pickles: I am not entirely sure that that is right. If you whistlebrawl to the Audit Commission, it will pass it on to the auditor. It acts just as a glorified post office. It does not do anything itself; it just passes it on. It is certainly our intention to make an order under the Employment Rights Act to ensure that auditors continue to be named as a prescribed person for whistleblowers. We think that that is probably enough. It is immensely important that whistleblowers have the ability to do their business. I am old enough to remember the downfall of T. Dan Smith and Poulson, which came from a whistleblower.

Q680 Ian Swales: So you would simply see the relationship being directly to whoever the local auditor of that public body is?
Eric Pickles: Yes. In effect that is what it is.

Q681 Ian Swales: So no role for the audit panel or anyone else? Just that?
Eric Pickles: Oh no, I think you need to be able to say that there is one person who can receive this information, who can act on it and whose duty is to act on it. I think that is right. If you are a bit nervous—you are working for an authority, and you have just looked up and said, “Oh my God, this is absolutely dreadful”—you do not want to speak to a committee, but to one person.

Q682 Ian Swales: Is there any fallback if someone raises something serious and the auditor fails to act? Or would you just be into the democratic process then?
Eric Pickles: The auditor has a duty to act. The auditor clearly has to come to a view about mendacious and vexatious claims, but the auditor must act. That is the case in public companies, and we have seen, both in this and in other countries, the consequence to auditors where they have been given information and have not acted. The professional ethics of auditors, particularly overseen by their
professional accounting bodies and the FRC, are sufficiently strong to ensure that that happens.

Q683 Ian Swales: So we do not expect public bodies to make it absolutely clear to everyone concerned what those routes are.

Eric Pickles: We think we can do this in terms of ensuring that we put auditors in under the Employment Rights Act. If the Committee feels that there is a loophole, please tell us, and we will do our best to address that. I personally do not think there is.

Brandon Lewis: If anything, because it is going straight to the auditor, who is a separate body, there is independence from the authority. It will actually be more straightforward under the new scheme than it has been, when you either go to the auditor or through the Audit Commission in the first place, who then refers the matter to the auditor.

Q684 Ian Swales: Let’s not go back over the ground again, but there is still the issue of who pays for that piece of work. We have already talked a lot about that.

Eric Pickles: There is no change. It will be paid for in exactly the same way as it is paid for now.

Q685 Chair: One final question. You intended to set up quite a healthy market in auditors, and you would probably accept that we are beginning to see that you end up with a small group of auditing practices dominating the market, and that, over time, there are dangers around pricing when that occurs. I wondered what your thinking was and what you were proposing to do to try to meet your intent to have healthy competition in the market for auditors?

Eric Pickles: I may be wrong, but I thought that the Audit Commission was the fifth largest accounting firm in Britain—I think that it was of that magnitude. Prior to the start of these new arrangements, I think that there were five companies in. There are now an additional two, and in total 13 had pre-qualified.

When the smaller authorities come in, that core of seven is likely to increase, and I would very much welcome that. You are quite right, Mrs Hodge, to say that we need to have a healthy market, and I would say that the market now is healthier than it was prior to these new arrangements.

Brandon Lewis: The sector itself has a large role to pay. Talking to the Local Government Association, many of them are very keen on their ability to drive down those costs and get good value for money in auditor’s fees, partly through the straight competition of companies competing with each other for the business, but also because those local authorities are very focused on every penny they spend and how they spend it, as they want that money for their front-line services. So they will negotiate.

In particular, one of the interesting things is that the small authorities will come in and, hopefully, see the sense in working together to procure together. As the Secretary of State said, this may well end up being sector led, and that is where we see more ability to drive down those costs in a good, competitive market.

Chair: Richard?

Mr Bacon: Mr Brandon Lewis has just answered my question.

Chair: I hope that that is the case. I have to say that our experience in the Public Accounts Committee is that, often with the best intentions, actually, these things all too easily get concentrated in the hands of very few. Then you see prices going up, but we will watch with interest.

Eric Pickles: So far, thank goodness, it has gone the other way, along with all the indications. I remain, as you can imagine, Mrs Hodge, an optimist with a song on my lips.

Chair: Thank you. We will submit our report to you before Christmas.
Written evidence

Memorandum submitted by the Audit Commission

Summary

1. The Audit Commission’s comments build on our response to DCLG’s consultation on the draft Bill, which is attached. They follow the broad headings in the call for evidence. However, we have also commented on other aspects including the future of data matching and the proposals for smaller local public bodies.

2. Our key comments relate to:
   — the need for effective safeguards for the independence of auditors: we think there should be properly constituted audit committees;
   — information at a national level about the outcomes of the local audit process, to support accountability to Parliament for public money disbursed to local public bodies;
   — the likely impact of local appointment on audit fees;
   — the need to balance the policy aim of opening up the market with ensuring auditors have the necessary capabilities;
   — the careful management of the transition, to avoid pressure to increase audit fees;
   — the scope for further savings in audit costs under the existing arrangements;
   — a consistent framework for the audit of local public bodies—including health bodies—to ensure proper accountability for public money;
   — the need for clarity about the future of the Commission’s National Fraud Initiative (NFI); and
   — the need to develop appropriate arrangements for smaller local public bodies.

Localism and Decentralisation

Local auditor panels

3. We believe that the proposals for local auditor panels do not adequately support auditors’ independence.

4. There is a risk that the panels, particularly where they are shared by a number of bodies, will result in duplication and, more concerning, confusion with the role of the audit committee and the body’s own governance arrangements for handling audit matters.

5. Instead, it would be preferable to require all local public bodies to have a properly constituted audit committee, complying with relevant guidance, such as already exist in central government and the NHS.

6. Existing arrangements can be built on to develop effective audit committees. Most local bodies already have these, or equivalents, although bodies may need to review the membership and functions, to ensure that they can carry out the full role envisaged for a local auditor panel. Local bodies could still procure auditors jointly through shared arrangements, but would look to their own audit committees to oversee the appointment process, the ongoing exercise of auditors’ functions and the maintenance of the relationship between the auditor and the audited body.

7. We recognise the practical problems in sourcing independent members. Therefore, in our view, there should be a statutory duty on all members of audit committees to act in the interest of safeguarding the independence of the auditor.

8. However, in practice, it is how the members discharge their responsibilities, ie the mindset they apply and the competencies that they bring to bear, that is as important as their formal independence. Therefore, more detailed guidance should cover the skills and experience, including in relation to financial matters, which need to be represented on audit committees, building on the FRC’s Guidance on Audit Committees.

9. The proposed duty on the local auditor panel to advise the auditor—and for the auditor to consult the panel—when the auditor is proposing to issue a public interest report, undermines the independence of the auditor, who currently has, and in our view must keep, unfettered discretion to issue such reports.

Auditors’ Special Powers

10. Local auditors exercise specific public functions, beyond the normal functions of an auditor. Auditors’ independence in discharging these functions must not be constrained by audited bodies’ refusal to meet the related costs incurred in doing so.

11. The Bill should provide a statutory mechanism for auditors to recover reasonable costs incurred in exercising these statutory powers.
Appointment and resignation of auditors

12. There is no provision for monitoring local public bodies’ compliance with their new duty to appoint an external auditor. To support transparency, relevant government departments should collect details of auditor appointments to local bodies within their remits, and make these available publicly.

13. Resignations can arise when auditors consider that they can no longer carry out the audit effectively and often reflect significant concerns about the governance of the body, or a fundamental breakdown in the relationship between the auditor and the body. Bodies may prefer to accept any reputational risk caused by an auditor’s resignation, rather than face that auditor investigating and publicly exposing failings, or weaknesses, in the local public body.

14. Significant time could elapse between the effective date of the removal, or resignation, of the outgoing auditor and the new appointment. Consideration should be given to extending the Secretary of State’s power under Clause 15 of the draft Bill to appoint an auditor in such circumstances. This would make it clear to authorities that the removal or resignation of an auditor has real consequences that, as in the private sector, audited bodies should seek to avoid.

Scope

15. Schedule 2 does not designate pension funds as “relevant authorities” in their own right. Given the scale of the assets and liabilities managed by these funds, it is essential that these bodies continue to be audited as separate entities, rather than as an integral part of the administering local authority.

Transparency

Accountability to Parliament

16. Local public audit is a key element in departments’ accountability system statements, which are published alongside their annual governance statements.

17. Departmental Accounting Officers rely on the audit process for assurance that the funds they have distributed to local public bodies have been safeguarded and accounted for properly. The Audit Commission currently produces a number of annual audit publications, summarising the results of auditors’ work at local public bodies, which provide this assurance.

18. The Commission also publishes reports, based on information collected from audited bodies and appointed auditors. This enables the Commission to report on significant issues, such as levels of reported fraud (through our Protecting the Public Purse series of reports), and on topical financial management issues in the local government sector, showing how local government responds to financial challenges and associated risks. Drawing on and analysing data about the sector as a whole strengthens the value of reports to local bodies and national stakeholders.

19. To support transparency at the national level, and because of the value to users of these reports, it is important that such reports continue to be produced. It would be possible for these reports to be produced by the NAO and it will need statutory powers to support this, including the ability to obtain the necessary information from local bodies and auditors.

Objections

20. We fully endorse the proposals to streamline the objections process. However, the proposed right of appeal, both against a decision not to consider an objection and a decision not to make an application to the court, is unnecessary. It creates a risk of additional legal proceedings, with associated costs, and is anachronistic: judicial review is more appropriate in these circumstances.

Audit fees

21. Based on the figures in the Impact Assessment, the additional net savings from the abolition of the Commission and the proposals in the draft Bill, above those already achieved, are modest.

22. In our recent procurement exercise, we secured significant reductions in the cost of audit. The Commission’s unique ability to guarantee audit firms large volumes of work through bulk procurement, coupled with its statutory powers to appoint auditors to 855 public bodies across the country, was critical to securing these fee reductions.

23. The Commission currently operates a “Post Office pricing” approach to equalize fees for bodies of a similar type across the country. This means all bodies have shared in the benefit of the new lower prices following the 2012 procurement, which covered 70% of the market. We believe there may be scope for the Commission to undertake an additional procurement for the remaining 30% to achieve even further savings and deliver lower fees for all bodies.

24. In future, strong competition for audits at the bigger, more commercially attractive bodies may drive down prices for them. Bodies that are geographically remote, or are considered unattractive on commercial
grounds, are likely to have to pay a premium for their audits. Therefore, moving away from the twin powers of bulk procurement and appointment will “unbundle” current arrangements and reduce the overall benefits to the public sector overall. Indeed, there is a significant risk that the lower level of fees the Commission has achieved will be eroded and possibly eradicated.

25. In addition, it will not be possible to offer the “Post Office pricing” approach, and so the benefits of lower audit fees will not be shared evenly, again to the disadvantage of bodies that are geographically remote, or are considered unattractive on commercial grounds.

THE MARKET

26. The audit of public sector bodies is quite different from that of private sector organisations. It is highly specialised, reflecting the complex legal, governance and financial control framework in which public sector bodies operate and the nature of the audit itself, which includes giving an annual conclusion on bodies’ value for money arrangements; reporting in public; determining issues of legality; and dealing with members of the public. Thus, many audit firms do not have the capability to act as auditors to public sector bodies.

27. While increasing the number of firms who carry out public sector audit work is important in the context of concerns about audit market concentration in the private sector it is vital that we maintain audit quality, and therefore entry to the market must be on the basis of competence.

28. As the barriers to entry in terms of technical knowledge and expertise are high, audit firms will need to have certainty of a sufficient amount of work over the medium term to sustain the required investment in the professional infrastructure and specialist technical support needed. The Commission’s recent procurement exercise, where substantial amounts of work were being offered, only managed to attract two new firms to the market, giving a total of seven. While a number of other new firms submitted tenders they were all rejected due to concerns on quality and price.

AUDITING STANDARDS

29. We agree that the regulatory framework should mirror the system in the private sector. However, Ethical Standards are written in the context of companies’ audits and do not take account of the wider scope of public audit, which poses different threats to auditors’ independence. Accordingly, the FRC will need to develop similar rules on the independence of auditors to those currently specified by the Audit Commission.

TRANSITIONAL ARRANGEMENTS

30. The Bill should allow for two transitions:
   — the first, when the Commission is abolished and the contracts are novated to a successor body in 2015; and
   — the second, when the new local audit arrangements are introduced after the existing contracts with auditors have run their course. This could be in 2018, 2019 or 2020, depending on whether and, if so, for how long, the existing contracts are extended.

31. If the contracts were to be extended to 2020, there would be scope to secure even further reductions in audit costs by re-tendering the contracts let in 2006–07. We recognise that to do so would be to delay the implementation of the new audit framework. There is a critical policy decision to be made between the benefits to the public sector of lower costs versus the benefits of introducing the new regime.

32. For the first transition, DCLG will need to transfer some of the Commission’s current functions to a successor body. The contracts are for the delivery of audits under the Audit Commission Act 1998. For the contracts to work, the successor body will need the Commission’s current statutory functions in relation to audit, including:
   — making, and specifying the terms of, auditor appointments;
   — setting scales of fees and determining variations to scale fees; and
   — making arrangements for the certification of grant claims and returns.

33. Provision will also need to be made to continue the current Code of Audit Practice, which is otherwise due to expire in March 2015, and for issuing supporting guidance to auditors.

34. Early implementation of parts of the new audit framework which impose any additional burdens on audit firms could lead to pressure to increase the level of audit fees.

35. The Commission is working closely with DCLG and other stakeholders to help ensure that both transitions will be implemented effectively. As part of this it will be important to retain and transfer relevant skills and expertise to those organisations taking on Commission functions, to support the effective management of change.
THE ROLE OF THE NAO

36. The draft Bill sets out the requirement on the Comptroller and Auditor General to prepare a Code of Audit Practice, but does not include an explicit power to issue guidance to auditors in support of the Code. This is essential to ensure that work is carried out locally, to consistent standards.

HEALTH

37. At the time of responding to the call for evidence, the proposals for health bodies were not available. It will be important to consider how the provisions of the draft Local Audit Bill will be applied to meet the specific circumstances of local health bodies, recognising their different constitutional relationship with central government.

38. Nevertheless, we think there should be as much consistency as possible between the audit arrangements for different types of public body across the different sectors, to ensure proper accountability for public money. Consideration could also be given to bringing Foundation Trusts within the scope of the new arrangements.

OTHER COMMENTS

Data matching and the NFI

39. Extending the purposes of data matching beyond the prevention and detection of fraud would give the Secretary of State, and the future operational owner of the NFI, the flexibility to make the most effective use of data matching in responding to the wide range of financial and operational risks that local public bodies face currently, or that may emerge in the future.

40. Clear criteria should be used to determine the future operational owner of the NFI. The timetable and process for making that decision also need to be clear and transparent. We suggested seven criteria on pp14–15 of our response to the draft Bill consultation.

41. Regardless of who owns the NFI, there should be a governance board, representing key stakeholder interests, to oversee the development and operation of the NFI.

42. It is not clear what mechanism will be available to the new owner of the NFI to ensure that participants follow up data matches. The Commission currently uses its appointed auditors for this purpose.

Smaller bodies

43. We believe the proposals for smaller bodies should be strengthened. The proposal that the smallest bodies, spending less than £25,000 each year, will need to appoint an auditor only to deal with matters that arise from electors’ questions or objections to the accounts needs to be considered further.

44. The matters that an auditor retained for this purpose would deal with will require knowledge of local public audit law, and will often be complex. It is not clear who would act as a retained auditor; how they would be remunerated; and whether they would have the requisite skills.

45. Auditors of all small bodies must satisfy some minimum eligibility requirements. These could be based on those for “registered local public auditors”, but tailored to the specific needs of the sector.

46. It is unclear to whom a local elector would go if they had fundamental concerns about the quality or delivery of auditors’ work at smaller bodies. DCLG will need to identify an appropriate body, if it is not the department itself, that can ultimately take responsibility for monitoring the system overall.

October 2012

Additional memorandum submitted by the Audit Commission

Thank you for the opportunity to give evidence to your Committee on Tuesday.

During the session you asked why whistleblowers did not go to local councillors. Councillors are not “prescribed persons” under the Public Interest Disclosure Act 1998. This means that an employee who took their concerns to councillors would not be afforded legal protection under the Act, for example from victimisation or dismissal.

At the end of the session, I promised to let you know how the £650 million claimed saving from our abolition over the five years from 2012–13 breaks down between the savings arising from the abolition of comprehensive area assessment (CAA) and the Commission’s other inspection activity, and the outsourcing of our audit practice. The figures in the Impact Assessment, published by the government with the Draft Bill, indicate that the bulk of the saving is attributable to the outsourcing of the audit practice. The savings from the outsourcing account for over half (56%) of the total and the savings from the abolition of CAA and inspection accounts for the balance.
The table below shows the breakdown by year. The figures are discounted to their net present value. As you will see, the savings total to £666 million. We assume the headline figure of £650 quoted by Ministers is a rounding.

<table>
<thead>
<tr>
<th>Year</th>
<th>Audit outsourcing</th>
<th>Abolition of CAA</th>
<th>Total (NPV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012–13</td>
<td>£54</td>
<td>£63</td>
<td>£117</td>
</tr>
<tr>
<td>2013–14</td>
<td>£82</td>
<td>£61</td>
<td>£143</td>
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<tr>
<td>2014–15</td>
<td>£81</td>
<td>£59</td>
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<tr>
<td>2015–16</td>
<td>£80</td>
<td>£57</td>
<td>£137</td>
</tr>
<tr>
<td>2016–17</td>
<td>£74</td>
<td>£55</td>
<td>£129</td>
</tr>
<tr>
<td>Five-year total</td>
<td>£371</td>
<td>£295</td>
<td>£666</td>
</tr>
</tbody>
</table>

The total savings from outsourcing include the savings in the Commission’s central running costs. As a result of the outsourcing, we no longer need to maintain a network of regional offices or to maintain IT, financial and HR support services on the same scale. However, the savings do allow for the costs of making staff in central support functions redundant.

The savings also include £5 million arising specifically from the abolition of the Commission in 2015—an average £2.5 million per year from 2015–16. This is based on the difference between the assumed annual running costs of the smaller Commission, £9 million from 2013–14, and the costs that are to be transferred to the FRC and NAO.

However, we now estimate that our costs will only be £7.5 million, so the savings will be smaller at £3 million—an average of £1.5 million per year from 2015–16—in line with our submission to the Committee.

These savings will be more than offset by the annual costs incurred by local public bodies in procuring audits. The Impact Assessment estimates that the net present value of these costs will be £4 million from 2016–17.

I hope that this provides the information the Committee was looking for.

I would also like to take this opportunity to clear up the point I made at the beginning of our session about the loss of accountability to Parliament for the outcomes of the audit process as a whole. The discussion then focused on whether there needed to be a national list of appointed auditors. Our main concern, which I don’t think I was able to get across fully, was that there is no provision in the draft Bill for any body in the new arrangements to pull together and report on the results of the audit process as a whole.

The “accountability system statements” now published as part of departments’ annual reports make clear that Accounting Officers rely on the annual accounting and audit processes for assurance over the £246 billion spent by local public bodies. But how do Accounting Officers know that these processes are working effectively?

Currently, the Commission provides essential assurance to departmental Accounting Officers, and through them Parliament, that the accounting and audit processes are working as intended, through its annual Auditing the Accounts publication. For example, the report highlights which local bodies produced their accounts late and those at which the auditor’s opinion on the financial statements or value for money conclusion was qualified. Below is a link to the report we published last year (this year’s report will be published in December).

http://www.audit-commission.gov.uk/audit-regime/support-guidance/auditing-the-accounts/Pages/auditing-the-accounts-1011.aspx

Departments would not have this information if the Commission did not provide it. We can produce this information because we:

— have put in place sophisticated electronic systems to collect the data from auditors;
— can require auditors to provide this information under their statutory terms of appointment; and
— meet the costs incurred by auditors in completing the information returns (estimated to be c £65,000 last year) through audit fees (as part of what the government refers to as the Commission “top slice”).

We think Accounting Officers will continue to need this information, but they need to decide how they will get it, from whom, and who will pay for the costs involved.

I hope this clarifies the point we were trying to make.

November 2012
Memorandum submitted by Robert W Black

AUDIT SCOTLAND STAFF NUMBERS; SUPPLEMENTARY NOTE

The total number of staff employed in Audit Scotland at 31 March 2012 was 255. The number working on financial audit was about 150–160, to the best of my recall, with the remainder involved in performance audit or corporate services. However, if the Committee wishes accurate information about the numbers working in different areas of the business, I would encourage the Committee to approach Audit Scotland directly.

In 2011–12 audit charges levied on audited bodies was £18.2 million and direct grant from the Scottish Parliament was £6.8 million. The latter was to cover the costs of non-rechargable audits such as the resource accounts of the Scottish Government and the Scottish Parliament.

Mr Bacon was also interested in the size of the team undertaking financial audit on the resource accounts of the Scottish Government. I had difficulty in giving an answer to this question because this number depends upon the allocation of staff time across different activities. Again I would suggest that Audit Scotland is the place to obtain an accurate figure.

October 2012

Memorandum submitted by the Local Government Association

INTRODUCTION

1.1 The Local Government Association (LGA) exists to support, promote and improve local government. We will represent local government’s interests and support councils through challenging times, focusing our efforts where we can have real impact. We will be bold, ambitious, and support councils to make a difference, deliver and be trusted.

1.2 The LGA welcomes this opportunity to offer written evidence to the ad-hoc Committee established to provide pre-legislative scrutiny of the draft Local Audit Bill. This response builds on our earlier submission to the Communities and Local Government Select Committee inquiry into the future arrangements for the audit and inspection of local authorities and our responses to previous Department for Communities and Local Government (DCLG) consultations on the future of local public audit.

SUMMARY

— The proposals for local public audit are part of a new approach that devolves responsibility locally. They place the emphasis on greater transparency, stronger local accountability and sector owned and led improvement—the proposals should be assessed in this context.

— The proposed requirement for auditor appointments to be made on the basis of advice from an independent audit panel comprising a majority of independent members and an independent chair is both unnecessary and impracticable. It should be deleted from the Bill.

— Sufficient flexibility should be retained to allow councils to come together to explore the opportunities for joint procurement of audit.

— 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 Commission’s value for money profiles and financial ratios analysis tool are of potential on-going value to the sector and we are keen to work with the Commission to explore the synergies with LG Inform (the sector’s own data comparison tool).

— We do not agree that the NAO should undertake examinations which include identifying “improvements” in local government. Clause 94(3)(b) should therefore be deleted from the Bill.

— The Bill should be amended to introduce a requirement on the NAO to consult the LGA on its programme of studies and to involve the sector in the conduct of individual studies. The LGA and NAO should be required to agree a Memorandum of Understanding setting out how they will work together.

OBJECTIVES OF THE PROPOSED ARRANGEMENTS

1.3 The Government’s proposals for local public audit are part of a new approach to assessment and inspection that places greater weight on stronger local accountability rather than central monitoring and reporting.
1.4 The deficiencies of the previous “new performance framework” with its panoply of centralised targets, performance indicators, Government office monitoring, data reporting and multiple inspections have been well documented. These limitations include the following points:

— National targets and assessment regimes by their nature encourage compliance with centralised objectives inhibiting the ability and opportunity for locally elected councils to respond effectively to the priorities identified by local people and communities.

— The assessment and inspection regimes have considerable compliance costs diverting scarce public resources away from direct delivery. In our evidence to the Communities and Local Government Select Committee inquiry the LGA estimated these costs to be in the order of £900 million per annum though others, including the NAO, arrived at higher estimates.

1.5 Instead the new approach—of which local public audit is part—devolves responsibility locally and places the emphasis on greater transparency, stronger local accountability and sector owned and led improvement. The proposals for local public audit need to be assessed within this wider context, not apart from it.

LOCAL APPOINTMENT

1.6 The Committee’s call for evidence invites views on whether the draft Bill provisions empowering local bodies to appoint their own independent external auditors will provide adequate safeguards, for example, to ensure independence.

1.7 In our view the proposed requirement for appointments to be made on the basis of advice from an independent audit panel comprising a majority of independent members and an independent chair is both unnecessary and impracticable. It should be deleted from the draft Bill.

1.8 The proposals are unnecessary for a number of reasons. Firstly, the eligibility requirements and regulation process provided under Part 4 of the draft Bill will be sufficient to ensure the professional integrity and independence of potential auditors. In practice this means that:

— Audit firms will have to comply with the rules and practices governing the eligibility of firms to be appointed as local public auditors and the qualifications, experience and other criteria individuals must reach before being permitted to carry out a local public audit and sign off an audit report. These will be set by the professional accountancy bodies (recognised supervisory bodies) which will be responsible for registration, monitoring and discipline for local public audit.

— Recognised supervisory bodies will monitor the quality of audits undertaken by their member firms and investigate complaints and disciplinary issues.

— The accountancy bodies themselves will be recognised and supervised by the Financial Reporting Council which will be the overall regulator. The FRC will be able to issue guidance to supervisory bodies. The Accountancy and Actuarial Disciplinary Board (part of the FRC) can investigate significant public interest disciplinary cases and impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors.

— The approach auditors must follow when auditing local public bodies is set out in the audit codes of practice which will in future be the responsibility of the NAO to develop and maintain.

“If there needs to be an audit committee with a majority of independent members in order to select an independent auditor there is something wrong with the process for determining auditors’ eligibility for the role.” Feedback from a County Council.

(Source: LGA, June 2011 response)

1.9 Secondly, councils already operate within a complex regime of existing safeguards and controls designed to guarantee regularity and propriety including the requirement to set balanced budgets, to restrict borrowing to what is affordable, maintain sound systems of internal financial control, publish financial statements and secure continuous improvement. Monitoring Officers and Section 151 Officers ensure the legality and financial prudence of decisions.

1.10 And finally, councils are already responsible for procuring large volumes of goods and services in order to discharge their wider functions and have the skills and ability to appoint their own auditors. Indeed the Government has recognised that there are “...no barriers in terms of expertise that would prevent local public bodies appointing their external auditors...” (paragraph 57, Government response to the future of local audit consultation, January 2012).

1.11 We also believe the proposals to be impractical because councils’ experience demonstrates that it will be very difficult for some authorities to source appropriate (ie suitably knowledgeable and qualified) independent people to appoint to a committee, especially given the amount of time required to understand the complex environment within which councils operate. Of those councils expressing a view on this issue 89% indicated it would be difficult to source independent members compared with 11% who said it would not (paragraph 5.7 Future of local public audit—consultation: Summary of responses, January 2012).

“The requirement to establish an audit panel is excessive and potentially unworkable as there will be difficulty in finding suitable independent members with the requisite skill set.” Feedback from a Shire district.
"The appointment of an independent auditor panel is considered to be an unnecessary bureaucracy. The requirement for independence is a clear duty on the appointed auditor and is implicit and explicit in the culture and legislation surrounding auditing.” Feedback from a County Council.

(Source: LGA response to draft Bill consultation, September 2012).

1.12 Foundation Trusts, Universities and Further Education Colleges appoint their own auditors. In the absence of any compelling evidence to support the need for passing these responsibilities to unelected people we continue to be of the view that the current audit committees provide a good basis for making recommendations to council about the appointment of auditors. Approximately 80% of councils already have some form of audit committee with the remit to challenge, review and scrutinise member and officer decisions on financial issues. This may include independent members and is often chaired by members of the opposition group. There is no reason to suggest that these arrangements could not provide a good basis for making recommendations to council about the appointment of auditors.

1.13 Giving councils the freedom to appoint their own auditors provides an opportunity to consider new approaches. We envisage there will be significant interest in some form of joint procurement. Sufficient flexibility should therefore be retained to allow councils to explore the opportunity to procure audit services, for example on a “class” basis or a joint basis at local, regional or national level.

TRANSPARENCY

1.14 The Committee’s call for evidence invites views on whether the provisions in the draft Bill will ensure that the results of audit are accessible to the public in a transparent and intelligible manner and data of interest to the public is easily available so that local bodies can be held to account for local spending decisions.

1.15 We see audit as one of the key mechanisms providing accountability for public resources. The primary audience for audit and audit reports should be local people and communities, including the voluntary sector and business community.

1.16 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.

1.17 As the Audit Commission has noted: “published financial information has become even more difficult for the general public to understand” (paragraph 20, Audit Commission draft Strategic Plan 2010).

1.18 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.

1.19 In terms of the availability of data to enable local people to hold their councils to account for spending decisions councils already publish a wide range of information and data locally about their policies, performance and use of resources.

1.20 In addition the LGA has developed LG Inform, a free online service which allows local government officers and councillors to access and compare key data. It contains performance and financial data, as well as contextual data, across a range of services and themes. Users can view reports for every one of the 800 data items, make comparisons with other groups of authorities, and create their own charts or reports using the data. In 2013 a new version of LG Inform will be launched which allows the public to view the data, either for their own area or for an area of their choice, and choose their comparison groups as well. This will give local people easy access to data to make performance and cost comparisons.

LEGACY AND THE WINDING UP OF THE AUDIT COMMISSION

1.21 The Committee’s call for evidence invites views on whether the provisions in the draft Bill make adequate provision for the Commission’s liabilities and ensuring that the expertise built up by the Commission is not dissipated.

1.22 As part of the work it undertakes to support local auditors the Audit Commission has developed and maintains value for money profiles which bring together data about costs, performance and activity of councils and fire and rescue authorities. It has also developed a financial ratios analysis tool to assist local authorities to compare their financial performance on a range of financial ratios against similar bodies.

1.23 These tools and the expertise necessary to maintain and develop them are of potential on-going value to the sector as a means of helping councils understand their performance in comparison with others. Raising public awareness of the tools could also provide an additional means of helping local people hold their councils to account. We are therefore actively exploring the synergies with LGA Inform (the sector’s own data comparison tool).
The Role of the National Audit Office

1.24 The Committee’s call for evidence invites views on the intended role of the NAO and specifically whether the arrangements for value for money are adequate and whether in time the NAO will take over the role of the Audit Commission.

1.25 The draft Local Audit Bill gives new powers to the National Audit Office to undertake examinations into the economy, efficiency and effectiveness with which English councils have used their resources in discharging their functions. Any examination is to be carried out for the purpose of:

- ensuring that the use of resources by a government department to fund councils represents an economical, efficient and effective use of resources; and
- identifying “improvements” that may be made by local authorities in the economy, efficiency and effectiveness with which they use resources in the discharge of their functions.

1.26 We do not agree that the NAO should undertake examinations which include identifying improvements.

1.27 The Government already supports a sector-led approach to improvement led via the LGA with funding provided via “top slice.” Vesting improvement activity in another separate organisation is therefore inappropriate and risks duplication and a waste of scarce public money. The sector itself is better suited to undertake this activity, working with the LGA.

1.28 We therefore propose that the new power described in Clause 94(3)(b) should be deleted from the Bill. This view is supported by a large majority of the responses we have seen from councils commenting on this Part of the draft Bill.

1.29 However we do acknowledge the potential value of the NAO undertaking studies that focus on the use of resources by government departments to fund council activities (though we are aware that not all in the sector agree) because of the synergies with the NAO’s primary role of helping to hold government accountable on behalf of Parliament for how government makes use of their resources.

1.30 As the NAO prepares to embark on these studies it is important to draw on experience of the Audit Commission’s studies programme and to respond to the recommendations of the Communities and Local Government Select Committee inquiry into audit and inspection about the need to develop a coherent and coordinated programme of studies. We therefore propose that:

- The number of NAO studies undertaken each year should be limited to a maximum of six because experience demonstrates that the sector does not have the capacity to respond to and implement the recommendations from a large number of studies each year;
- the NAO should have regard to studies that the sector itself, including the LGA, may commission as part of sector led improvement;
- there should be consultation and agreement with the sector on the theme of the studies in advance; and
- the NAO should not investigate and make judgements about the performance of individual local authorities or indeed classes of local government.

1.31 These views are supported by over 80% of the responses we have seen from councils commenting on this part of the draft Bill.

1.32 Whilst the policy narrative accompanying the draft Bill appears to indicate that DCLG are sympathetic to the LGA’s views it seems they have no levers to influence NAO. We therefore propose that, as a minimum, the draft Bill should be amended to introduce a requirement on the NAO to consult the LGA on its programme of studies and to involve the sector in the conduct of individual studies. The LGA and NAO should be required to produce and agree a Memorandum of Understanding setting out how they will work together.

October 2012

Additional memorandum submitted by the Local Government Association

Draft Local Audit Bill

During my oral evidence session on the draft Local Audit Bill I undertook in response to questioning by members to provide some further information on LG Inform. I have also taken the opportunity to provide additional details in respect of the LGA’s peer challenge.

LG Inform

LG Inform is an on-line data and benchmarking service developed by the Local Government Association (LGA) as part of its support for local government. It provides local authorities and fire and rescue services with access to more than a thousand data items available for all areas. The data includes key performance data about their area, alongside contextual and financial information. Users can view the data, make comparisons with other councils or groups of councils, or construct their own reports bringing several data items together.
Peer Challenge

Peer Challenge is one way we are supporting councils as part of the approach to sector led improvement. In 2011–12 we delivered a total of 97 peer challenges and this year we are on target to deliver over 100. We have a range of different peer challenges which cover specific services such as children’s safeguarding or planning through to our corporate peer challenge. The take-up of our corporate peer challenge has been increasing and since September 2011 we have carried out 42 of these challenges and have a further 60 booked or in discussion with councils. In addition, since September 2011, we have delivered a further 73 peer challenges of councils safeguarding services or other service areas such as planning.

The feedback we have received from our peer challenges is extremely positive, with all councils saying they would recommend a peer challenge to other councils.

27 November 2012

Memorandum submitted by the Society of Local Council Clerks (SLCC)

Submission of Evidence to the Ad Hoc Committee

1. This submission evidences the SLCC Support for the proposal for smaller bodies.

2. This submission is on behalf of the Society of Local Council Clerks, the professional body for Parish and Town Clerks and other officers working in the local council sector. The society currently has over 3,700 members working for 4,500 local councils in England and Wales. The society provides training, advice, support and networking opportunities for those working in the local council sector. It is also involved in developing national and international qualifications that are relevant to its membership, increasing the professionalism of officers working for local councils.

3. The society has put forward a joint proposal with NALC, for a sector-led body to undertake the procurement of audit services for smaller bodies (under £6,500,000). This proposal is referred to in the draft Bill and has been welcomed by ministers.

4. The proposals were debated at two of the society conferences in the first half of 2012, both times attracting an audience of over 50 clerks and finance officers from some of the most active local councils. Those events
indicated a strong preference for a sector-led procurement solution and also a desire for a higher audit threshold than the initial £1,000 suggested in the first consultation.

5. The society’s National Executive Council (made up of elected representatives from the society’s 45 county branches) gave the society’s formal support to the proposal at its meeting on 16 February 2012, endorsing the creation of a sector-led audit procurement body as the Society’s preferred option for audit procurement for small bodies.

6. The limited assurance regime can be considered a success, the proportion of unqualified audit opinions for parish and town councils reaching 95% in 2012, compared to 87% in 2011. Only 14 councils out of 9,449 seem to be showing consistent failures to produce accounts.

October 2012

Memorandum submitted by the Association of Chartered Certified Accountants (ACCA)

DRAFT LOCAL GOVERNMENT AUDIT BILL

Call for evidence by the ad hoc committee responsible for the pre- legislative scrutiny of the draft local government audit bill

Comments from ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our 154,000 members and 432,000 students throughout their careers, providing services through a network of 83 offices and centres. Our global infrastructure means that exams and support are delivered—and reputation and influence developed—at a local level, directly benefiting stakeholders wherever they are based, or plan to move to, in pursuit of new career opportunities.

ACCA welcomes the opportunity to comment on the impact of the draft Bill on the future of local audit provision. The ACCA Global Forum for the Public Sector has considered the matters raised and their views are represented in the following.

Summary

ACCA’s main summary points are as follows:

— There is a missed opportunity in the draft Bill to address the issue of how audit quality will be maintained across the local government sector. The draft Bill is wholly focused on cost and makes no assessment of the impact that a downward fee pressure could have on audit quality.

— The issue of auditor independence could be better addressed by strengthening the role of audit committees, for example by including a statutory duty for all local authorities to have audit committees with the membership structure and responsibilities set out in the draft Bill.

— The proposals set out in the draft Bill outline a fragmented and complex audit framework with multiple oversight bodies involved. In our view this arrangement has the potential to increase the scope for gaps in accountability to arise, particularly, where new models of public service delivery are concerned.

— We were pleased to see that in the draft Bill most elements remain the same for auditors making reports in the public interest.

— There is more work to be undertaken by the Government in relation to resolving the problem of limited competition in the audit market, so as to encourage more small and medium sized audit practices into the market in the future.

— There is still very little clarity about what activities the NAO will implement and will not implement, such as co-ordination of whole of government accounts consolidation packs, limited assurance frameworks for small audits etc. Also, it is still not clear how their role will work in practice, particularly given that they will not hold local authorities to account in the same way that central government is held to account.

Specific Comments

1. Localism and decentralisation—specifically, whether the provisions empowering local bodies to appoint their own independent external auditors will work and provide adequate safeguards, for example, to ensure independence and the extent to which the provisions in the draft Bill are future-proofed to take account of emerging changes such as the accounting arrangements for community budgets and the sharing of services.

ACCA recently responded to the Government’s consultation on the draft local audit bill and said that, whilst we thought the proposals for audit safeguarding auditor independence were heading in the right direction, we
were disappointed that the draft Bill was proposing to do this through the introduction of audit panels and not existing audit committees, thus adding an additional layer of bureaucracy. In our view this will lead to an unnecessary burden and additional costs on local authorities. Also, the audit panels’ intended relationship with the auditor and the audit committee is not clearly set out in the draft Bill. This is likely to confuse rather than enhance governance arrangements within a local authority.

Whilst we support the criteria and functions set out in Part 3 of the draft Bill we believe that these functions should be performed by audit committees and a statutory duty should be included within the draft Bill for all local authorities to maintain an audit committee. This would make governance arrangements comparable with those operating in the private sector.

Local authorities should be required to make the necessary membership changes to audit committees and take on the functions of advising on auditor appointments, maintaining relationships with the auditor and dealing with public interest reports. The audit committee’s functions and membership requirements would include those set out for the draft Bill together with the wider duties set out in the Financial Reporting Council’s (FRC) revised guidance for audit committees (September 2012), albeit this will also need to be adapted to reflect the different context of local government. In our view it is more likely that the arrangements will be future proofed if they are aligned to the models working in the private sector. Health trusts, for example, already follow the private sector model of governance.

We have reported in our response to the Government that there should be an independent chair of the audit committee who is financially competent and has a sound knowledge of local authority finances and the governance structures. The majority of committee members should also be independent.

We also stated in previous submissions to the Government that more attention is now being given to risk management and the establishment of risk committees for listed companies. We are aware that a number of local authority audit committees already take on this function, but believe that the draft Bill could be strengthened by setting out an audit committee’s responsibility in respect to risk management.

It is not clear from the draft Bill how auditor appointments will be made and independence assured in the case of shared services or community budgets. As services become more localised and fragmented there is a potential for accountability to fall through the gaps. Drawing upon experience, it was often the case for shared services that the Audit Commission would agree a lead auditor to co-ordinate the audit with the auditors of other bodies involved in the shared service. It is not clear how the audit will be co-ordinated in the future. Additional difficulties may arise where a public interest report is required. The draft Bill needs to clearly outline how the audits of shared services are co-ordinated in the future in the absence of the Audit Commission.

On the broader issues of whether the audit framework being proposed in the draft Bill supports localism, we would argue that it does not, for the following reasons:

— A significant number of local authorities will not have the opportunity to appoint local auditors for a further seven years until 2020–21 because of extension clauses within the contracts. Also, it seems irrational that there is no planned oversight of these contracts posts the Audit Commission from 2015.
— Rather than stripping away the layers of top down bureaucracy and oversight placed on local authorities, the Government is actually adding to them with at least four new national bodies having a role including, the National Audit Office (NAO), potentially the National Fraud Authority (NFA), the Financial Reporting Council (FRC) and the LGA responsible for undertaking peer review assessments. These bodies will have to co-ordinate with a myriad of other scrutiny arrangements eg audit panels, audit committees, inspectorates, external auditors, internal auditors and scrutiny committees.

We believe that the fragmentation of the audit framework as proposed in the draft Bill has the potential to blur governance and accountability arrangements, frustrate co-ordination and make it less likely to detect service failure, respond to emerging challenges and judge whether value for money is being achieved in the future.

2. Transparency—in particular, whether the provisions in the draft Bill will ensure that results of audit are accessible to the public in a transparent and intelligible manner and data of interest to the public is easily available so that local bodies can be held to account for local spending decisions.

We are pleased to see in the draft Bill that most elements will remain the same for auditors making reports in the public interest. We also agree that public interest reports on connected entities should be considered by the relevant “parent body”. However, from a practical point of view it is still not clear how public interest reports will be co-ordinated by potentially different auditors when they cover multiple local authorities or shared services arrangements.

We are also pleased that the draft Bill contains provisions to modernise the rights of the public to object to the accounts. The public now have access to a number of avenues for redress.

We believe that the real challenge for both auditors and local authorities is to make data accessible and understandable for the public. But we also hold the view that the public want independently assured data. By simply putting all items of expenditure on a web site provides neither assurance of accuracy of the data or the
context in which it is spent. We would suggest that the costs imposed on local authorities potentially outweigh the benefits. We are supportive of the Public Accounts Committee’s recommendation in its 10th report on “implementing the transparency agenda” (2012) that a cost benefit analysis needs to be performed.

We are concerned about how transparency will be achieved through the Local Government Association’s (LGA) new peer review programme. In the Government’s response to the CLG committee’s report it said “it wanted councils to embrace the spirit of openness, transparency and accountability so that local people can understand what they are doing and to hold them to account. The sector as a whole must be robust in challenging poor performance”. But only recently this aspiration has been challenged by three peer-reviewed authorities refusing to publish their assessments. Given this development it is unclear how in the future transparency will be addressed and potential service failure detected.

3. Lower audit fees—will the draft Bill ensure that the audit fees paid by local public bodies are competitive and offer value for money as well as securing the reduction in the overall costs which the Government has predicted.

In our view the impact assessment analysis of market forces and competition on fees was not comprehensive as it was drawn from research directly commissioned by the Government and does not reflect wider academic research. At least two recent studies show that audit fees have a tendency to increase and not decrease in the long-term. For example, a study conducted by the London School of Economics (LSE) in 2002 identified an increase 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.

Similarly, a 2009 study comparing “in-house” to outsourced private sector audit suppliers delivering financial audits in the public sector in Western Australia found that for 178 public agencies outsourced audits are, in general, more costly than in-house audits in the long term. More specifically it found that outsourced audits are more costly than in-house audits for small statutory authority audits, whereas for large and complex statutory authority audits, the in-house supply is equally as efficient as the outsourced service.

There is also anecdotal evidence from our European partners of the impact that low fees can have on audit quality. For example, this has become of such a concern in Belgium that the Government is requesting an amendment to a European Commission public procurement directive to prevent ‘statutory audit’ being tendered out, as it believes audit is being compromised by low fees.

4. The market in auditing service—specifically, whether the operation of the market in audit services is sufficiently competitive to allow smaller firms and organisations such as mutuals and co-operatives to be able to compete with large well-established companies and the effectiveness of the draft Bill in promoting competition in the delivery of audit services.

We agree with the CLG select committee that “unless the Government can crack the problem of the very limited competition in the audit market in the UK, it will always 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. Since the contracting out of audit services earlier this year there have been two new entrants to the market, which is a step in the right direction, but this needs to go further than is currently the case to provide local authorities with a genuine choice of audit firms which includes small practices.

We believe that further work is required by the Government to 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.

5. Auditing standards—specifically, whether the draft Bill will ensure that there is an effective and transparent regulation of public audit, and conformity to the principles of public audit and whether the arrangements in the draft Bill will ensure that both good practice and lessons to prevent failure are disseminated adequately.

As well as developing the Codes of Audit Practice the Audit Commission was instrumental in specifying the audit approach for those aspects of the audit not covered by professional standards, such as the value for money conclusion and review of whole of government accounts consolidation packs, certification of claims and returns, limited assurance approach for small audits and developing standard forms of audit reports, guidance and advice for auditors, and deals with technical queries from auditors on technical issues etc, for both private audit firms or Audit Commission staff. It is not clear from the draft Bill which body will take on these functions to ensure that audit is seamlessly delivered by audit providers in a cost effective and coordinated way. Without any clarity in the draft Bill it has to be assumed that the NAO will be taking on these functions, if not, there will be a fragmented approach to ensuring consistent standards is applied.

Also, in the absence of the Audit Commission it will be important that the FRC works with the supervisory bodies in specifying the technical standards for firms seeking to operate in the sector. We have previously reported that the Audit Inspection Unit (AIU) of the FRC would be best placed to oversee and regulate audit
performance as it has already undertaken this role for a handful of local authority audits at the invitation of the Audit Commission. It would, of course, need additional capacity and resources and assurances would have to be sought in this respect.

6. The objectives of the new arrangement—specifically, what are the objectives for the new arrangements and how will their impact be measured.

Our understanding of the Government’s objectives of the new audit arrangements is to give local authorities more choice over appointing their own auditors, whilst at the same time minimising audit fees. A notable absence from the objectives is how the Government intends to ensure the quality of audit is not compromised and that it is delivered consistently for local government. In the absence of the Audit Commission there will be no longer a requirement for comparable audit between individual authorities. In the future, what a local authority gets in the way of audit is what the governing body is prepared to pay for.

We believe that the Government’s other objectives include providing greater transparency through the publication of data and self-regulation by local authorities themselves through the peer review process. Although these objectives have their merits they are based on assumptions, such as the accuracy of data and the capability of it being interpreted by the public and that local authorities are well governed and value for money is achieved. While this is true for a large number of authorities it will not always be the case. In the absence of a future champion for VFM it will be much more difficult to identify scandals, service failure and whether public money is being well spent in the future.

We support the development of an evaluation framework to measure and monitor whether the objectives of the new arrangements are being fulfilled.

7. The winding-up of the Audit Commission—for example, whether the arrangements in the draft Bill for winding up the Audit Commission made adequate provisions for liabilities and that expertise built up by the Commission is not dissipated.

Our understanding is that the Audit Commission is now reduced to 70 staff with direct responsibility for regulating the market. In our view the expertise of the Commission, and its knowledge of the health and local government sectors, has been dissipated since the decision was made in 2010. This is a considerable loss to the sector.

We were disappointed with the impact assessment prepared by the Government that the focus was wholly on cost with no reference to quality or the impact of a downward fee pressure could have on audit quality. This should be of concern to the NAO and Treasury.

In our response to the Government’s consultation of the Local Government Draft Audit Bill we expressed our disappointment that the Government was still questioning the realism of its own figures. The cost benefit analysis that was provided by the Government was compiled using a very narrow basis on what applied to the Government’s accounts rather than accounting for the overall impact of the changes. We are sceptical about the government’s claims that savings of £650 million can be achieved over a five-year period given a number of anomalies contained within the impact assessment statement.

8. The intended role of the National Audit Office—specifically, whether the arrangements for value for money are adequate and whether in time the NAO will take over the role of the Audit Commission.

Against the severe spending reduction background, increased devolved services and the fragmentation of the governance, audit and scrutiny framework we believe that it will become more difficult for an organisation such as the NAO to judge performance across public services in the future.

In our previous submissions to the Government we have supported the NAO taking over the Audit Commission’s value for money function following its demise. We are also aware that the NAO has now established a reference group and value for money team to undertake a smaller range of value for money studies.

However, we have concerns about its resources and capacity to undertake value for money, as well its experience of the local government sector. The Audit Commission has few remaining value for money experts and we believe that a key opportunity was missed earlier in the process to transfer key staff to the NAO. As a result a wealth of experience has been lost to the sector at a time when the sector is changing so much.

We also understand that the NAO will not hold local authorities to account in the same way it does central government. It is not clear how this will work in practice and whether this will open up scope for local authorities to be called to account by the PAC in the future.
9. Audit arrangements for health services, with particular reference to the new NHS “system architecture” and new health responsibilities for local authorities under the Health and Social Care Act 2012, which will take effect from 1 April 2013.

As far as we are aware the local external auditor will have responsibility for auditing the new health and well-being responsibilities. This should not present an accountability gap at a local level as the audit will be conducted in accordance with the Code of Audit Practice.

However, the fragmentation of audit means that it will be increasingly difficult to gauge whether value for money has been achieved nationally, unless, the new health and well-being responsibilities are subject to a NAO value for money review. Given that the proposal is to limit VFM studies in local government to a handful of studies, this area is at risk of being crowded out by competing priorities. In addition, a local authority will find it increasingly difficult to compare its performance against other local authorities and to know what good practice looks like as there will be no benchmark.

October 2012

Memorandum submitted by CIPFA

Summary

— To be successful the new local audit regime must embody the unique features of local public audit set out by the Public Audit Forum in 1998.

— In particular, the greater accountability required when funding public services from taxation is crucially reliant on public sector auditors being independent from the organisations being audited.

— The new framework is vulnerable to being “watered down” if the Local Audit Bill does not make specific reference to these factors that make local public audit unique.

— Arrangements for the registration of auditors should reflect the factors that make local public audit unique.

— The membership and operation of the Financial Reporting Council (FRC) needs to be reviewed if it is to successfully perform the new and distinct role envisaged for it in the draft bill.

— The professional standards and other guidance for auditors should be extended to reflect the wider scope of public audit.

— The draft Bill provides sufficient flexibility to meet local circumstances, but does not strike an appropriate balance between prescription and guidance.

— Proposals for the audit of local health bodies have yet to be finalised; but since they should be guided by the same principles of public audit the issues arising are expected to be similar to those for local authorities.

Auditing Standards

1. This evidence deals first with the auditing standards since these inform our responses to the other issues raised by the Committee.

2. If it is to be established on sound foundations the new local audit arrangements must unambiguously incorporate the three main principles set out by the Public Audit Forum in 1998. These principles together articulate the unique characteristics of public audit:

   (a) Independence of public sector auditors from the organisations being audited;

   (b) The wide scope of public audit, covering the audit of financial statements, regularity, propriety and value for money; and

   (c) The ability of public auditors to make the results of their audits available to the public, to democratically elected representatives, and to other key stakeholders.

3. These principles are motivated by recognition that funding public services from taxation creates a need for a different and much deeper level of accountability than applies in the private sector. Above all, the public expects 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 also whether this money has been spent economically, efficiently and effectively for the purposes intended.

4. These three principles are in turn elaborated by CIPFA’s 2010 report Public Financial Management: A Whole System Approach. This analysis establishes that public sector bodies must be held accountable to the electorate and society, and that public sector management must be held accountable to elected representatives. To ensure that public sector bodies meet these standards of conduct they must be subject to high quality external audit and review in accordance with appropriate professional standards.

1 http://cipfaimprovement.net/Policy-and-Guidance/Reports/Whole-System-Approach-Volume-1
5. If, as is proposed, public audit is to be regulated by the Financial Reporting Council (FRC), then the distinctive stakeholder groups and purposes of public sector reporting must be deeply embedded in the design and operation of the FRC itself. To this end, the membership and operation of the FRC would have to be reviewed so that it reflects the broader scope of public audit and the distinctive local government legal framework. The set up and operation of the new regulatory regime will also need to be appropriately funded.

6. The factors that make local public audit unique also need to be reflected in arrangements for the register of auditors to be established under the draft Bill. This allows for the register of auditors to be kept with the register of statutory auditors under the Companies Act 2006. CIPFA considers that it is important for the Bill to make clear that this single register is a register of firms approved for the delivery of public audit within the meaning of the Bill, and that separate registers of individual, appropriately qualified public auditors will be maintained by their professional bodies.

7. While there is some overlap between the scope of quality control activity in the commercial sector and the public sector, there are also some very material differences as a result of the subject matter, focus and scope of local public audits (and, by implication, the training necessary for the effective performance of those duties). When designing a system to replace that of the Audit Commission, therefore, the additional responsibilities of public audit must be explicitly built into the new control environment.

8. In contrast to the Companies Act, the draft Bill is silent on arrangements for the appropriate training and supervision of registered public auditors. The arrangements for dealing with this have been the subject of detailed consideration between the Department for Communities and Local Government (DCLG) and the profession, and CIPFA believes it is important for the Bill to either specify these arrangements or to state where and how this will be addressed.

9. CIPFA also considers that the professional standards and other guidance for auditors may need to be extended to reflect the wider scope of public audit and to include specific reference to public bodies. This could be achieved by amending the Ethical Standards themselves; by issuing supplementary guidance (such as an FRC Practice Note on the application of the Standards); or by including the necessary requirements in the Code of Audit Practice to be published by the Comptroller and Auditor General.

10. It follows from these arguments, based on the overarching importance of auditing standards, that only by a specific reference within the draft Bill to the factors that make local public audit unique will it be possible to prevent the new framework being “watered down” in the future.

LOCALISM AND DECENTRALISATION

11. The independence of public sector auditors from the organisations being audited, one of the three main principles of local public audit, is currently achieved through the Audit Commission managing the appointment process. The abolition of the Commission will make the same degree of essential independence more difficult to achieve. Under the proposed regime, it is the independence of those advising the local body on the audit appointment that is intended to ensure the independence of the local auditor.

12. The DCLG has chosen to legislate for the creation of auditor panels rather than the alternative of reinforcing the status and independence requirements around the audit committees that many local authorities have now established.

13. One consequence of this decision is the potential for interfaces and areas of overlap which may arise between the audit committees and proposed auditor panels. In order to address the potential for confusion in this area, there should be integrated guidance for local authorities covering all areas of their responsibilities in relation to external audit. In addition the eligibility criteria for independent members of auditor panels should be extended to ensure independence from any other potential interests such as partners, staff and alumni of audit firms that are authorised for public audit.

14. The draft Bill does not address the other qualities that will be required of an auditor panel member, such as relevant experience or expertise. CIPFA has already published relevant and longstanding guidance in relation to auditor committees. This states that an auditor committee’s membership should be balanced, “objective, independent of mind and should have the skills and experience that the guidance considers necessary”. Since similar skills and experience will be required by auditor panel members, CIPFA considers that this is one element of the integrated guidance covering both auditor panels and audit committees which we have recommended to the DCLG should be produced.

15. CIPFA believes the draft Bill provides sufficient flexibility for local bodies to put in place arrangements (including joint panel arrangements) to suit local circumstances. However, we are concerned that the draft Bill does not strike an appropriate balance between prescription and guidance. For example, Clause 12 (regarding independence) seems to be too prescriptive for a Bill. This would be better suited to secondary legislation, which would allow a more flexible response to changes and emerging issues such as community budgets.

16. To allow professional judgements to be exercised and to provide flexibility to address novel situations as they arise, the statutory duties and powers of local authority auditors have always been expressed in fairly high-level terms. Since 1972, there has been a Code of Audit Practice to supplement legislative requirements. Before the creation of the Audit Commission, this was a non-statutory code; since the creation of the Commission, a statutory code has been approved by Parliament at five yearly intervals. The Code is principles-based and a range of supplementary guidance is provided to ensure auditors perform quality audits.

17. 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. In the context of the proposed structures, CIPFA considers that the Comptroller and Auditor General (through the National Audit Office) should be responsible for this Code. Similar considerations will apply in respect of the audit of local health bodies, which should be covered by this or a similar Code.

18. The complexity of the continually evolving interplay between local government finance and professional accounting and auditing guidance means that supplementary guidance for the Code will continue to be required. Currently this includes standing guidance to auditors explaining what they must or cannot do, technical advice notes, training and helpdesk support to promote consistency; all this is done to avoid each auditor having to “reinvent the wheel” in interpreting new Acts, Government controls or professional developments. The draft Bill needs to be amended to make it clear that the Comptroller and Auditor General has the power to issue such supplementary guidance.

19. Support is also given to auditors to help them through difficult issues of which they may have had no prior experience such as complex public interest cases, objections work and complex financial transactions such as PFI schemes. The provision of guidance and support requires significant knowledge and experience of both professional standards and local government finance, which the NAO will need to develop or make arrangements to access.

20. CIPFA agrees with the proposals in the draft Bill to extend the powers of the Comptroller and Auditor General to carry out examinations into the economy, efficiency and effectiveness of public sector bodies to English local authorities. CIPFA also agrees with the proposals that the NAO should be able to undertake thematic value for money studies regarding all sectors whose bodies are subject to audit under the draft Bill.

21. The proposals recognise that the NAO will not directly replace the work of the Audit Commission in this area. Fewer value for money studies will be carried out by the NAO than were previously carried out by the Commission, and the NAO will not have a locus to assess the performance of individual councils nor to hold them to account as it does central government departments. So there will be a reduction in the external pressure on councils to achieve value for money, even though it is still included in the proposed scope of local audit.

22. The Government’s transparency agenda and data publication initiative will make local authorities more accountable for individual transactions but it will not make them any more accountable for their overall performance at either service or authority level. The new requirements result in the publication of data rather than information. Public audit will therefore remain a crucial link in the accountability chain, something the Commission, and the NAO will not have a locus to assess the performance of individual councils nor to hold them to account as it does central government departments. So there will be a reduction in the external pressure on councils to achieve value for money, even though it is still included in the proposed scope of local audit.

23. The right to make formal objections is open to abuse by vexatious complainants. Given the additional opportunities to question authorities created by the transparency and Freedom of Information Act requirements, CIPFA supports the proposals in the draft Bill to modernise the right to object to the accounts.

24. The draft Bill preserves the rights of taxpayers to inspect accounting records and supporting documents, and to raise objections to the statement of accounts if they think there are matters that the auditor should report on in the public interest, or items of unlawful spending.

25. The draft Bill provides for public access to the statement of accounts and reports issued by the local auditor. CIPFA considers that the arrangements are sufficient to ensure that local bodies can be held to account for local spending decisions.

26. Different arrangements will apply to smaller bodies, which will not be subject to external audit. CIPFA believes that, provided smaller bodies comply with the requirements, these additional transparency requirements proposed for smaller bodies are sufficiently robust to ensure that they will be accountable to the electorate, and that they will help ensure that public money will be safeguarded. The existence of internal audit is an important reason for coming to this conclusion, and we would have concerns if an internal audit report was not available.
27. We do not think that it is clear from the Bill how non-compliance with the proposals will be addressed. A number of smaller bodies have regularly failed to publish their accounts, and CIPFA believes that there should be a sanction (such as the removal or restriction of the power to raise tax) available to ensure accountability to local taxpayers.

**Audit Arrangements for Health Services**

28. The Government proposes that local health bodies will be subject to audit under the new local public audit framework. Whilst this arrangement should ensure consistent audit arrangements for local health bodies and the local authorities undertaking new health responsibilities under the Health and Social Care Act 2012, we would note that these arrangements are still under development and therefore not included in the draft Bill. Until these arrangements are finalised, the suitability of the proposals for health services cannot be fully assessed. CIPFA would, however, expect that the comments we have made in respect of local authorities will generally be applicable to local health bodies.

*October 2012*

**Memorandum submitted by ICAEW**

**Summary**

1. Faced with a stubborn deficit and difficult public finances, we must manage public money more wisely to ensure it is spent effectively and efficiently. Local public audit should play a rigorous role in this.

2. An audit is a vital tool to check that an organisation is presenting its financial information in a “true and fair” way. The public needs the correct financial information about local public bodies that use tax payers’ money to deliver vital public services—to measure their performance and efficiency, and to hold them to account.

3. We are supportive of the principles to provide a streamlined approach to the local public audit regime mirroring where practical, the arrangements set out in the Companies Act 2006 and Ethical Standards. This will minimise confusion and duplication of arrangements across the public and private sector. In particular we think the draft Local Audit Bill will ensure audit independence, transparency of audit results, and accountability.

4. The Department for Health (DOH) urgently needs to clarify the audit arrangements for local public health bodies, and consult with the audit profession to ensure that their requirements are practical, feasible and workable. We understand the Department for Communities and Local Government (DCLG) will provide details of their arrangements in good time (by the end of 2013); we have no such assurance from DOH in respect of health audits.

5. Until we have information on the scope and guidance for local public audits, it’s difficult to say whether the Bill will lower audit fees or reduce the overall cost of public audit to the tax payer. Proportionality, risk and quality will play a part in determining whether savings will occur.

6. The market for local public audit services will be modestly competitive, though firms will need a certain standard of skills, knowledge and experience to bid for contracts.

7. To uphold standards and audit quality, it’s vital that audit firms carrying out local public audits are properly licensed, registered and monitored. The most cost-effective way to ensure this would be for recognised supervisory bodies (RSBs) like ICAEW to carry out this work.

**Responses on Specific Areas of Bill**

**Localism and decentralisation**

8. There are still a few gaps to be worked through, but broadly, the provisions empowering local bodies to appoint their own independent external auditors should provide adequate safeguards to ensure independence. The Bill does this by providing for an independent audit panel. Independence of the accounting arrangements will be dealt with through accounting and audit regulations underpinned by the ethical standards of the accounting profession, and the local authority accounting code is provided by the Chartered Institute of Public Finance and Accountancy (CIPFA).

9. An outstanding issue here is the need for Whitehall to develop specific guidance to help local public bodies (like local councils and clinical commissioning groups) to appoint external auditors. Those bodies need time to appoint auditors, and audit firms need time to prepare for and bid for those contracts. We understand DCLG are aiming to provide this by the end of this year. This is far from clear in relation to the DOH and local public health bodies, as we explain later in this submission.

**Transparency**

10. Under this Bill, we think the results of audit are accessible and transparent, so people will be able to hold local bodies to account. The Bill won’t actually change the way information is presented or made
accessible. Local public bodies are still subject to freedom of information laws, enabling members of the public to request information that isn’t made immediately available. The Bill provides for bodies to publish the audit report, and they will also publish annual reports.

Lower audit fees

11. It is difficult to say whether audit fees will be lower, or better value for money. This is because the Bill doesn’t impose specific levels of audit fees (it can’t—that would be anti-competitive), and also because we don’t yet have enough information from DCLG, and particularly from the DOH, on the likely scope of those audits. It’s also not yet clear how some of the estimated cost figures have been calculated. So audit fees won’t necessarily be any cheaper.

12. There are a number of factors operating in the background which will also affect the financial outcomes on fees:

12.1 There is no certainty as to how long the current economic climate and fiscal mandate will last. Both are putting pressure on local bodies, which could raise their risk profile (eg, in terms of material mis-statement, or irregular expenditure) and put upward pressure on fees to cover sufficient work to cover these.

12.2 There is currently a strong focus on audit quality, both from the FRC and also at an EU level. However, there is a danger that the expectations regarding lower audit fees could both fetter the discretion of the auditor to carry out whatever work they deem necessary to discharge their responsibilities and promote the concept of “cheap” audits rather than advancing the quality of audit in this sector.

12.3 The concept of proportionality has been touched on in the legislation but not fully explored. It may be that for smaller government bodies a proportionate audit approach in line with Auditing standards, or replacing the need for audit with accountants reports will achieve some element of saving.

12.4 The current arrangements whereby audits are awarded in bulk under national contracts means that bidders are assured on volume quantities, and this assurance is built into existing pricing arrangements. In the new regime there will be no assurances on volume so firms are likely to build in the fact that they might only win one audit into their prices.

13. A further factor which has bearing on the amount of fees will be the categorisation of audits as “major audits”. These are subject to more stringent reviews and controls and thereby have a greater overhead in their operation, both in terms of the controls expected of the bodies, and the additional work auditors have to undertake in order to provide the higher assurance. We have concerns that the definition currently proposed for major audit may not necessarily address the principal aspects of public interest and may not achieve proportionate outcomes as a consequence.

The market in auditing service

14. There is a dilemma we have seen in other regulated areas that the objectives of seeking to open up the market and competition, whilst at the same time sustaining quality and consumer protection are self-conflicting. The quality standards built into the draft Bill here mean that competition will be a little limited, because audit firms will need a specific level of skills and knowledge to bid for and to conduct these audits. Smaller firms or new market entrants will take time to acquire this, so in practice, these contracts are likely to go to the top ten or fifteen audit firms. In addition the compliance infrastructure necessary to meet the quality standards is expensive and is likely to be a further hurdle to smaller firms.

15. Nevertheless we believe the draft Bill in this case is striking an appropriate balance. As well as ensuring that, within the limits of skills and experience-related barriers to entry for audit firms, the most important factor here is that firms bidding to carry out this work will need to be licensed, registered and monitored. This will help to ensure the right level of audit quality and scrutiny of auditors’ work.

16. We presume the committee’s reference to mutual and co-operative audit firms stems from the original idea that the Audit Commission’s practice arm could be spin off as a mutual. This has not happened, and there are not any other mutual or co-operative audit firms, though many are partnerships. We would also note that bond and limitation of liability arrangements can be a particular barrier to these sorts of entities in providing services to local government. The draft arrangements for these are not clear in the bill and some further detail is required.

Auditing standards

17. It is vital that rigorous audit and ethical standards are upheld in public audit, and that the regulatory structure is transparent and effective. The same standards apply in both the private and the public sector. In addition to these, the National Audit Office (NAO) will develop a code of audit practice for local government (it’s not yet clear whether the same will happen for local public health bodies—but it should).

18. It should also be noted that the Financial Reporting Council (FRC) and Recognised Supervisory Bodies (RSBs) like ICAEW will license, register and monitor the firms carrying out this work. These bodies already carry out these roles in the private sector and include mechanisms for effective dissemination of good practice.
and applying lessons learned. It’s also worth noting that audit in the private sector is one of the most regulated markets and professions and is therefore well-rehearsed in the necessary processes for a good quality audit reporting ethos in the public sector.

**The objectives of the new arrangement**

19. The draft Bill’s foreword suggests the objectives of the new arrangements are to save public money, maintain audit quality, and improve the accountability of local services by devolving local public audit to a local level, and tackle the perceived problem of the Audit Commission being simultaneously the regulator, commissioner and provider of local audit services. There are simple measures that can be made around financial cost, but they do not tie into quality delivery. There are metrics currently used by the FRC and the RSBs in monitoring the quality of audits and these would be readily transportable into local public audit. Complaint volume can be a further indicator which is also monitored by the FRC on company audits.

**The winding up of the Audit Commission**

20. The main liability that needs to be provided for in winding up the Audit Commission is the staff pension fund, and we understand that this is being resolved.

21. It is important to ensure that the Commission’s expertise is not dissipated. We would expect that many ex-Commission staff will be recruited by the audit firms that take over local public audits.

22. However, DCLG could provide greater information on how the transitional arrangements will work. We still don’t have enough knowledge of these winding up arrangements to be able to comment in detail on this, and we are concerned that these should be properly thought through to ensure continuity in transition.

**The intended role of the National Audit Office**

23. When the abolition of the Audit Commission was first announced, the simplest fix would probably have been to hand its responsibilities to an expanded NAO, but we have now moved beyond that point. Furthermore, this might not have addressed concerns about the Audit Commission’s triple role as regulator, commissioner and provider of local audit services.

24. As things stand at the moment, the NAO’s only role is to write the code of audit practice for local government. We know it will do this for local government; this should also be done for local health bodies.

25. We think the most cost-effective arrangement is for an RSB like ICAEW to take on the role of licensing, registering and monitoring audit firms conducting local public audits. We think this would be more cost-effective than asking the NAO or RSBs with less experience to pick this responsibility up. We already have the abilities and experience in quality assurance and monitoring.

26. We haven’t yet been able to supply an estimate of how this much will cost, because we don’t yet have the information from DCLG and DOH on the scope of the audits they will outline.

**Audit arrangements for health services**

27. It is still not at all clear how the arrangements will apply for local public health bodies. We understand DCLG will be providing specific guidance to help local public bodies (like local councils and clinical commissioning groups) to appoint external auditors, and we would encourage them to produce this on a timely basis.

28. However, we have heard no such assurance on the provision of this guidance from DOH. Local public health bodies need clarity from DOH on the terms and scope of the audits. The Audit Commission has appointed auditors to Health bodies. The audit work will commence in April 2013, when their new responsibilities under the Health and Social Care Act 2012 take effect. However, without clarity and guidance on the requirements for these audits, local public health bodies and audit firms are in the dark, and audit firms will be unable to properly prepare and start their audits. The committee should urge DOH to clarify this as soon as possible.

29. We suggest that the audit arrangements should be the same for local authorities and for local public health bodies. This will ensure consistency in the approach and practice of audits, and it will also help to limit the overall costs. If the regulatory regimes and requirements vary, this will add to the costs, as different systems and processes will have to be put in place.

30. We would also encourage DOH to consult more closely with the audit profession, via professional bodies like ICAEW, as they determine the specifics of the new arrangements for health services. Having a more consultative and open planning process now (rather than simply handing over a finished product to the audit profession just before they’re expected to start bidding for contracts and conducting audits) will help to ensure that the final arrangements are feasible and workable, and minimise problems as the new arrangement gets underway in 2013.
Other issues

31. The proposals for administering the resignation of auditors follow Companies Act processes. Unfortunately these themselves are unclear and in need of clarification. Care is needed to ensure that the arrangements are clear and do not replicate the uncertainty of company law.

Who We Are

32. ICAEW is a world-leading professional accountancy body, operating under a Royal Charter and working in the public interest. We provide leadership and practical support to over 138,000 member Chartered Accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

33. We are a Recognised Supervisory Body (RSB), which means that we license, register and monitor 3,788 member audit firms and 718 insolvency firms, and our regulation of 11,000 member firms is overseen by the UK Financial Reporting Council and the Irish Auditing and Accounting Supervisory Authority. In 2011, our Quality Assurance team reviewed 2,230 firms.

34. Building on our extensive expertise as a regulating body, ICAEW intends to apply to license, register and monitor audit firms conducting local public audits, mirroring the role we currently play as an RSB for private sector audits.

November 2012

Additional memorandum submitted by ICAEW

Thank you again for the recent opportunity to give evidence to your committee on the draft Local Public Audit Bill. We’ve been working closely with DCLG over the last two years, so were pleased to speak with the committee.

As you pull together your report over the coming weeks, I would like to offer our further assistance. I would also like to clarify two points which we discussed on academies and local health bodies, and provide a little more information on the technical concepts of Public Interest Reports (PIRs) and going concern.

Academies

Although academies are not within the scope of the Bill, the committee did discuss them at some length. I thought you might be interested to hear a little more about our work on this, with the Department for Education and the Education Funding Agency. At the instigation of our member accountancy firms, many of which are providing accounting and audit services to academies, we are working to resolve various problems with the regimes and schedules for accounting and assurance requirements being imposed on these schools. A lack of clarity around the audit requirements, and a rushed timetable, could mean that school accounting officers have less resource to spot errors or fraud in academy finances. We would be happy to update you on this.

Foundation Trusts (FTs)

During the evidence session, you asked about failing Foundation Trusts. I would like to clarify our role in relation to the audit of these FTs. Monitor is their independent regulator, and we provide audit monitoring services to Monitor. This means that we review a small sample of the completed audits of FTs, checking that they are of a good quality, and that auditors are complying with Monitor’s audit code. We provide these results to Monitor, who summarise them on their website.

This work is in relation to Foundation Trusts, not NHS Trusts. NHS Trusts fall under the remit of the Department of Health and the Audit Commission, and are not within the scope of our work with Monitor.

Public Interest Reports (PIRs)

The concept of PIRs is often to highlight something that has not already been covered in the financial statements that are being audited, and is not already in the public domain. A PIR could be made on a very significant matter that has arisen during the course of the audit, which the FT had not already highlighted in the financial statements. Or it could be made on something so significant that has to be made subject of an immediate report, rather than wait for the conclusion of the audit.

Examples of when a PIR might be issued are:

— When the FT has misused public money to an extent that there has been a material impact on the funding available to treat patients;
— The financial position of the FT is such that it would not be considered to be a going concern;
— The management of the FT is not fulfilling its statutory obligations (therefore having a significant impact on the effective running of the FT);
— There is evidence that a senior officer, director or governor is or has been perpetrating a fraud.
GOING CONCERN

There was some discussion of the concept of “going concern” at the evidence session. In relation to Foundation Trusts (FTs), each FT is required to assess its own going concern, and provide the auditor with information on how it is planning to remain a going concern. The Foundation Trust Annual Reporting Manual indicates that the accounts should be prepared on a going concern basis unless management intends to apply to the Secretary of State for the dissolution of the NHS FT without the transfer of the services to another entity or has no realistic alternative but to do so.

The FT would report on going concern in the financial statements in accordance with accounting standards and auditors would carry out work on going concern in accordance with auditing standards. If there is a significant concern which is not reflected appropriately in the accounts, the auditor would report accordingly in the audit report. The Audit Report is sent to the FT and Monitor, and this report would already be in the public domain. The FT includes the audit report with its accounts which are laid before Parliament and presented publicly at its AGM.

A deficit showing in the accounts does not necessarily mean that the FT has a going concern issue or that the auditor should report a going concern issue in the PI. Monitor will apply financial risk ratings to all FTs (published on their website), have regular performance monitoring procedures, which would be escalated where there were greater concerns. Monitor also exercise their statutory powers of intervention where this is necessary. Details are made public on Monitor’s website.

CONSISTENCY OF AUDIT LICENSING ACROSS THE PUBLIC SECTOR

Although not of direct relevance to the draft Local Public Audit Bill, it is interesting to note that while audit firms will in future need to seek a licence from a body such as ICAEW to audit local public bodies, no such licence is currently or prospectively required for the same firms to carry out audit work in the central government sector.

We would be delighted to speak with your colleagues and staff on the committee if they would like any further information to help them with the report.

11 December 2012

Memorandum submitted by Grant Thornton UK LLP

PRE-LEGISLATIVE SCRUTINY OF THE DRAFT LOCAL AUDIT BILL

About us

Grant Thornton UK LLP is a leading provider of assurance, advisory and tax services to individuals, privately-held businesses, public interest entities and the public sector.

We are one of the leading providers of audit services to the local authority, health, education, and housing sectors. In addition to our contract with the Audit Commission we hold framework contracts with the National Audit Office, Wales Audit Office, Audit Scotland and the Northern Ireland Audit Office.

We have been providing local public audit services for over thirty years. Given our long standing commitment to the public sector, and our extensive experience of providing audit services to local public bodies, we welcome the opportunity to submit a memorandum to the Committee conducting pre-legislative scrutiny of the draft Local Audit Bill (the Draft Bill).

Introduction

As requested, we comment below on each of the nine areas suggested by the Committee.

We have restricted our comments to a summary of the key points. Further detail to support the points can be found in our earlier responses to:

— the Select Committee looking at the decision to disband the Audit Commission (March 2011)
— the Future of Local Public Audit Consultation document (June 2011)
— the Draft Local Audit Bill Consultation document (August 2012).

For ease of reference, these responses are attached to the covering e-mail to this memorandum.
Summary

— the impact assessment of the Draft Bill is flawed in that it considers the impact of actions already taken but does not consider or evaluate options relating to appointment of auditors, which is the substance of the Draft Bill;
— the concept of auditor panels is complicated, inherently inefficient, costly and confusing in terms of local accountability, particularly as regards the relationship with local audit committees. We do not think they will work in practice;
— an independent appointments body with local authority representation is the most effective way of ensuring independence and allowing some local involvement in the audit appointment; and
— an independent appointments body with local authority representation is the most effective way of ensuring quality, choice and competition and also allows for skills retention following abolition of the Audit Commission.

Localism and decentralisation

We do not consider that the provisions in the Draft Bill for local appointment of auditors will work and, in particular, we think that the concept of auditor panels is fundamentally flawed. The proposed arrangements for establishment and consultation with auditor panels, and the need for specific rules on who can and cannot approve the audit appointment, appear overly complicated and inherently inefficient, costly and confusing in terms of local accountability.

The relationship of auditor panels with local audit committees has not been thought through, and we cannot see how they will work effectively in practice. We included commentary on a number of clauses in the Draft Bill in our response to questions three and eight in the Draft Bill Consultation document.

We have consistently argued that given the unique nature of local government, and in the absence of fully effective audit committees, an independent appointments body with local authority representation, is the most effective way of maximising independence. It is also the most effective way of supporting localism by giving maximum assurance to local taxpayers that the auditor is independent and maximum protection to officers and members of local public bodies. In our experience local government electors would regard direct local involvement in the audit appointment as a strong opportunity to challenge the independence of the auditor.

An appointments body, which could operate regionally or nationally, would also have the benefit of reducing the procurement burden on individual local authorities (and auditors), ensuring all authorities have an appointed auditor, and enabling greater economies of scale and therefore value for money in terms of cost, quality and continued investment in the sector. We comment further on these aspects in the sections below.

Transparency

In general, the Draft Bill proposes that the results of audit will be made available to the public in the same way as they are now.

We do not support making lots of detailed information available to the public. Other than for a very small minority of local electors, typically with a vested interest or personal agenda, we do not detect any desire of the public to “hold their local authority to account” in this way and it would not be practical or effective to do so. Rather, we believe the public wants assurance that this role is being carried out by professional auditors (including internal auditors) and that the role is being discharged independently.

We do, however, support the publication of Annual Reports and, in particular, believe public reporting in local government is in need of development given the complexity of the published financial statements. More accessible and meaningful summary financial and performance information would enhance local transparency.

We have some specific comments to make regarding transparency:
— the Secretary of State, NAO and the public will need to know that an auditor has been appropriately appointed and who the appointed auditor is. It is unclear who will be responsible for maintaining such a register, or how it will be complied and kept up to date;
— the Secretary of State, NAO and the public will also want to know that the local authority has published audited accounts. It is unclear who will be responsible for confirming and publishing this information;
— the provisions in the Draft Bill relating to public interest reports have not been sufficiently thought through (we comment further on this in our response to the Draft Bill Consultation); and
— there needs to be clarity on who local electors can turn to if they are not satisfied that the local auditor has dealt appropriately with their concern or complaint—at the moment it is transparent to local electors who that is (the Audit Commission).
Lower audit fees

We note that the impact assessment of the Draft Bill is flawed in that 40% fee reductions have already been delivered and will not be a consequence of implementing the Draft Bill. Indeed, we believe it is likely that fees will increase, not decrease, as a result of the Draft Bill given that:

— the benefit of economies of scale arising from bulk contracts will disappear;

— increased tendering costs are likely to be significant. Even using DCLG’s assumption that there will be up to 175 procurements rather than the potential 874 procurements provided for in the Draft Bill, there will be a significant increase in tendering costs given there is currently only one national procurement; and

— indemnities currently provided by the Audit Commission, specifically in relation to challenge work, will no longer be provided.

There is also a risk that audit fees may rise for the smaller and more geographically dispersed bodies, and for particularly high risk or otherwise “unattractive” audits. The benefit of a national or regional procurement process is that it allows for economies of scale and standardisation of fees across different local public bodies.

The market in auditing services

We note that the impact assessment of the Draft Bill is flawed in that there is already full competition with 100% of audits outsourced. The outsourcing followed a competitive process with commercially attractive “lots” to attract potential new entrants to the market. We therefore do not consider that the Draft Bill will be effective in promoting competition, and that the opposite is more likely.

The characteristics and complexity of local government require auditors to invest in understanding both the sector and the unique audit regime in order to deliver high quality audits. The wider scope of audit, public reporting and the relationship with local electors distinguish local authority audit from other audits and audit suppliers therefore use highly specialised and experienced teams. In order for “small firms” to make this investment, they need attractively sized bids, which national procurement allows.

We do not think it is realistic to envisage smaller firms and organisations such as mutuals and co-operatives bidding successfully for one-off audits without an inevitable impact on quality, consistency or cost.

We have consistently argued that the most effective way to reduce the cost of local public audit and increase choice is through a national or regional independent appointments body and some regulation of the market.

Auditing standards

We believe the Draft Bill will ensure effective regulation, but will be less effective than the current model in ensuring conformity with the Principles of Public Audit and promoting and disseminating good practice.

In terms of regulation, we note that:

— the quality monitoring regime will need to be broader in scope than for a Companies Act audit because of the wider scope of audit, for example, to cover Value for Money (VfM) work; and

— Ethical Standards will need to be tailored to cover the circumstances specific to the audit of local public bodies.

In terms of conforming to the Principles of Public Audit, the proposals in the Draft Bill are less effective than the current Public Audit Regime. In particular:

— independent appointment: we do consider the proposals for auditor panels are desirable or workable in practice; and

— public reporting: we do not consider the proposals for safeguarding the auditor’s position in reporting in the public interest have been thought through (see earlier comments).

It is not clear from the Draft Bill how good practice will be identified and collated from auditors or which body will be responsible for disseminating it.

Objectives of the new arrangements

We note that DCLG’s objectives of reducing the size and scope of the Audit Commission, increasing competition in the provision of audit services and reducing audit fees have already been achieved and will not be delivered through the Draft Bill.

The only objective of the Draft Bill is to allow local bodies to appoint their own auditor. The Draft Bill consultation papers do not identify or evaluate different options for appointment of auditors. These options include the status quo of some form of national or regional appointments body but with greater local authority involvement, which we would support. Similarly, the impact assessment does not evaluate the impact of the Draft Bill but rather evaluates the impact of actions that have already been taken. We commented further on this in our response to the Draft Bill Consultation.
Winding up of the Audit Commission

Whilst the expertise of the Audit Commission’s Audit Practice will transfer to firms under TUPE, much of the expertise within the Audit Commission’s central functions has already been lost.

The Audit Commission is a highly specialist procurer and regulator of local public audit. This is evidenced by the quality of audit services provided over 30 years and the success of the procurement rounds, including the contribution made recently to delivering 40% fee reductions.

The procurement and audit appointment expertise within the Commission cannot be replicated across up to as many as 874 auditor panels. In our view this expertise should be retained in one national appointments body, with greater local authority involvement than at present.

*Intended role of the NAO*

We believe the arrangements for ViM are adequate and support extension of the NAO’s role to include consideration of local delivery of national programmes.

Local ViM work is best integrated with the financial statements work to ensure consistency, avoid duplication and minimise costs. Local auditors have experience and knowledge in the wider scope audit and by combining the local ViM audit with the financial statements audit, the auditor is best placed to report on the overall performance of the local authority and deal with questions from local taxpayers (which typically relate to ViM not the financial statements).

Further thought needs to be given to:

- how the NAO will coordinate work and engage with local auditors to avoid duplication of effort;
- how reports summarising the results of audits (for example, highlighting those authorities that have failed to publish audited accounts by the required deadline) will in future be produced. Such reports have been well received in the past and are a key part of transparent public reporting; and
- how comparative information and best practice will be collected, collated and published in the new audit framework.

These points relate to our earlier comment about the NAO needing an up to date list of appointed auditors.

We believe the NAO could, in time, take over the regulatory role of the Audit Commission, specifically the appointment of auditors to local public bodies.

*Audit arrangements for health services*

We believe that it will be important to ensure that, with the introduction of the new NHS “system architecture”, audit arrangements for all new bodies and not just Clinical Commissioning Groups facilitate the retention of existing local audit expertise.

The Bill proposes that the Public Audit Regime applies to Wales and Scotland but only to central government in England. We believe this inconsistency is confusing to the public and detracts from, rather than enhances, accountability and transparency.

*Other points—small bodies*

We note the definition of small bodies to be those with annual turnover of less than £6.5 million. We believe this threshold is too high and commented on this in our response to the Future of Local Public Audit Consultation document.

We have also commented on the detailed proposals for audit of small bodies contained in the Draft Bill, including the proposal that bodies with a turnover below £25 thousand should not be subject to external audit, and have concerns that the practical implications of the proposals have not been thought through.

In relation to small bodies we support the development of some sort of sector managed body to deal with audit appointments, which is similar in principle to our recommended regional or national appointments body for principal bodies.

*October 2012*
Memorandum submitted by Mazars LLP

SUMMARY

This memorandum sets out our evidence on three aspects of the draft Local Audit Bill currently before the Committee:

— the need for greater clarity on how the proposed new arrangements will be coordinated;
— the risks posed by the more complex options for the auditor panel arrangements; and
— factors that may affect the competitiveness of the market for local public audit, and suggested approaches to dealing with them.

OVERALL COHERENCE OF THE PROPOSED NEW LOCAL AUDIT REGIME

The framework for local public audit set out in the draft Bill represents an adaptation of the private sector model for audit appointment and regulation to local public bodies with some additional features such as the role of the National Audit Office in maintaining a Code of Audit Practice and issuing guidance to auditors.

Whilst each element of the proposed new framework draws on established practice in other sectors, we are less clear how the whole system will be coordinated. It will be important to ensure that there is a reliable and efficient mechanism for identifying emerging issues (whether from auditors’ field work, quality reviews of auditors’ work, feedback from authorities or other sources) and providing timely guidance to auditors.

INDEPENDENCE

We support the objective of securing a strong independent element in the appointment of the auditor. Where an authority’s audit committee (or equivalent) is able to fulfil the proposed role of the auditor panel, we believe that the new arrangements are workable.

But we are concerned at the potential complexity of the alternative models permitted by the draft Bill, where the authority’s audit committee and the auditor panel are separate. We believe that there are two main risks here. Firstly, managing the four-way relationship between auditor, authority, audit committee and auditor panel will be complex and, in the case of contentious issues, potentially slow and ineffective. Secondly, the cost to both the authority and the auditor of working in such an arrangement is likely to be higher.

The independence of the auditor is particularly important where it is necessary for the auditor to consider making a report in the public interest. Part 3 Clause 13 (4)(b) of the draft Bill places a duty on the auditor panel to advise the auditor on any proposal to make a public interest report. The intention of this proposal may be to provide a source of support to the auditor if he or she comes under pressure from the authority not to make a public interest report. But we are concerned that it could have the unintended effect of reducing confidence in the independent judgement of the auditor. It is essential that the decision on whether to make a public interest report is the auditor’s alone, acting independently of both the authority and any auditor panel.

COMPETITION AND FEES

The arrangements set out in the draft Bill clearly have the effect of increasing local public bodies’ choice over the identity of their external auditor. For this choice to be meaningful and lead to a healthy competitive market, it is important that care is taken in the transition to the new arrangements.

The draft Bill’s impact assessment correctly recognises firms’ bidding costs as one source of upward pressure on costs. An important factor in determining the extent of this upward pressure is the future procurement timetable. If all local public bodies are required to procure their audit in the same short timeframe (say autumn 2016), the logistical and cost pressures on bidding firms will be considerable, potentially reducing the choice and value on offer to local public bodies.

We would welcome local public bodies being given the ability to roll forward their existing audit appointment for a limited period as we believe this would help reduce congestion in procurement and maximise choice and value.

We also see merit in the option of joint procurement by a group of authorities as this should reduce the cost of the procurement process for both authorities and firms. It could also help attract competitive bids for an authority whose audit may be less attractive to potential bidders as a standalone appointment (eg because it is geographically remote). Care would need to be taken to avoid inadvertently restricting the field of potential bidders if several firms are preventing from seeking appointment because of conflicts arising from their non-audit work at one or more authority in the joint procurement group. The risk of this could be reduced by authorities giving notice as early as possible of their intention to procure their audits jointly, allowing firms to plan ahead.
Mazars LLP currently holds a contract with the Audit Commission for the external audit of 33 local public bodies in the North East of England and North Yorkshire. The firm also holds a contract with the Commission for the limited assurance review of smaller bodies.

October 2012

Memorandum submitted by the National Audit Office

SUMMARY

1. This submission sets out, in response to the Ad Hoc Committee’s Call for Evidence, the comments of the National Audit Office (NAO) on the draft Local Audit Bill. It addresses:
   — the role of the NAO in the future local audit framework; and
   — other broader elements of the draft Bill.

INTRODUCTION

2. The audit framework for local bodies is one important element of the broader Accountability System which Accounting Officers of departments distributing resources to local bodies are responsible for implementing to demonstrate that value for money has been secured and money has been spent properly. The significant expansion of bodies delivering services locally presents challenges to parliamentary accountability as the Committee of Public Accounts recognised in its March 2012 report Accountability for Public Money.

3. The NAO briefed the Committee of Public Accounts in July 2012 on our approach to providing assurance in the wider context of devolved services. We have continued to develop our approach, taking in both those sectors and bodies that are affected by the abolition of the Audit Commission (eg local government) and those that are not (eg academies). This submission does not deal with matters outside the scope of the draft Bill, but the NAO would be happy to cover these wider issues with the Committee if it would be helpful.

ABOLITION OF THE AUDIT COMMISSION

4. The decision to abolish the Audit Commission ("the Commission") was a government policy decision. Whilst the NAO does not comment upon government policy, we have a legitimate interest, on behalf of Parliament, in helping to ensure that successor arrangements put in place by Government operate as a proportionate but robust system of local public audit. This is necessary both to provide departmental Accounting Officers with assurance regarding the use of funds provided by central government and to give confidence to taxpayers (national and local) about the way that their money is spent.

5. Since the Government announced in August 2010 its intention to abolish the Audit Commission, the NAO, alongside other stakeholders, has contributed views to Government on how its proposals could be implemented. The Comptroller and Auditor General (C&AG) gave oral evidence to the Communities and Local Government Select Committee as part of its inquiry in spring 2011 into the Audit and Inspection of Local Authorities.

THE NAO’S PROPOSED RESPONSIBILITIES

6. The NAO has been clear in its discussions with Department for Communities and Local Government (DCLG), the lead Government Department for the Bill, that any role in the future audit framework should align with our core role of providing assurance to Parliament and holding Government to account over its use of resources.

7. Consistent with this, the draft Local Audit Bill provides for the NAO to:
   — take on from the Commission the role of setting the Code of Audit Practice and supporting guidance, which together specify the framework of standards for auditors of local bodies to follow; and
   — carry out value for money work at local authorities, for specified purposes explained in the following sections.

Preparation of the Code of Audit Practice

8. Subject to parliamentary approval, we are content with the Government’s proposal that the NAO take on the role of preparing the Code of Audit Practice ("the Code"). The Code underpins local delivery of audits to consistent, high standards. Parliament has a clear interest in this as it provides substantial resources to local bodies. So it is appropriate for the NAO, as Parliament’s key source of assurance over the use of public money, to take on this role.

9. The draft Bill envisages that the Code should be updated every five years, as required by current legislation. The existing Code is struck at a high level and the Commission provides auditors with detailed supporting guidance. We expect to adopt a similar approach, and have highlighted to DCLG that the Bill should include a clause empowering the C&AG to issue guidance, which local auditors should have regard to.
10. The Commission produces separate Codes to cover the audit, respectively, of local authorities and of local health bodies. The draft Bill is silent on the Government’s intentions with regard to the audit of local health bodies, but we have indicated to the Department of Health our willingness, again subject to parliamentary approval, to take on the Code of Audit Practice role for local health bodies. It is therefore helpful that the draft Bill gives the C&AG discretion over whether to issue a single or multiple Codes.

11. The precise date at which responsibility for the Code would transfer to the NAO depends upon the passage of the Local Audit Bill through Parliament and resultant commencement arrangements. We have, though, begun to invest some resources in preparing for the role, and building our knowledge of local authority and health audit matters more generally. We anticipate that Commission staff engaged in preparing the Code and supporting guidance will, in due course, be eligible to transfer to the NAO under TUPE arrangements.

**Value for Money examinations**

12. The draft Local Audit Bill aims to clarify the C&AG’s power to undertake value for money examinations which include consideration of the local authority sector’s use of resources. It also provides a statutory right of access to information held by local authorities in support of this work. We see a real opportunity here to develop value for money examinations which provide a “whole system” view, taking in both the national and the local perspective, and therefore consider that this is an important part of the draft Bill:

— To help hold central government to account, Parliament has a legitimate interest in how resources passed down to local bodies are used, and how local bodies contribute to the achievement of national policy objectives. Whilst Parliament will previously have drawn some assurance from national value for money work carried out by the Audit Commission, this work is now winding down. The NAO is well-placed to operate in this space. For example, our current study on local government financial sustainability will consider central government’s understanding of the impact of significant financial changes on local authorities’ ability to remain financially sound whilst effectively delivering local services.

— NAO evaluations of the value for money of key national programmes or policies can only benefit from drawing in evidence of local delivery to provide a true “end-to-end” picture. Current work we have planned or underway on the Universal Credit project, on adult social care and on reforms to Housing Benefit are good examples of this. Our outputs—for example, our June 2012 report *Central government’s communication and engagement with local government*—are enhanced significantly by our ability to observe and comment on issues from the perspective of both Whitehall (within and across departments) and local government. This is increasingly relevant as government policy cuts across departmental silos, fresh patterns of local delivery develop and local authorities commission services from and develop partnerships with a diverse range of providers. The draft Bill should provide an unambiguous basis for this type of insight, supported by access to the information we need to do this work.

— There is an opportunity to develop studies that do not have a focus on holding central government to account, but instead draw upon the NAO’s experience and expertise—for example, in structured cost reduction—to evaluate practice in local government. These studies should complement sector led initiatives such as the Local Government Association’s (LGA’s) work on sector improvement.

13. We are aware of concern expressed at the clauses in the draft Local Audit Bill regarding value for money evaluations of local authorities’ use of resources. The Committee’s own Call for Evidence, indeed, asks whether “...in time the NAO will take over the role of the Audit Commission”. We are clear that the draft Bill does not provide for such a fundamental change in the NAO’s role and would draw attention to the following:

— The legislation gives the NAO no role in auditing individual local authorities, nor is this a role which we seek. Individual local authorities will have their own external auditors, reporting locally, but within a national framework set by the NAO. NAO value for money studies will evaluate practice across the sector, to inform an end-to-end judgement on value for money overall. There is no intention on the part of the NAO to interfere with the primary accountability of local authorities to the local electorate.

— The NAO is funded by Parliament and currently produces around 60 value for money outputs per year. We have proposed to the Public Accounts Commission, which scrutinises the NAO’s budget on behalf of Parliament, that we expand gradually over a three year period to produce an additional six outputs per year, in order to accommodate additional studies designed to provide a more explicit end to end view. Whilst important, this does not represent a fundamental shift in the focus of the NAO’s efforts.

— We recognise the nervousness of the sector. The LGA has particular concerns over clause 94(1)(3)(b) of the draft Bill, which ascribes to the NAO a role in “identifying improvements” in local government. We believe that DCLG should revisit the clauses relating to examinations by the C&AG, in the light of the Committee’s pre-legislative scrutiny, to articulate more clearly the purposes underpinning the NAO’s work. We are content to work with DCLG on this.

14. We believe strongly that proposals for the development of the NAO’s value for money work provide an opportunity to enhance the value of the work we do. Our contact with local authorities highlights consistent...
concerns over the interface between central and local government when policies are designed centrally and implemented locally. The NAO is best placed to develop real insight into central and local government interaction and, using powers provided in the Bill, to assess its impact in terms of value for money.

**The Government’s Proposals for the Overall Audit Framework**

15. The draft Bill builds upon the Government’s proposals in its earlier consultation paper (*Future of Local Audit: Consultation*—30 March 2011).

16. In his evidence to the CLG Select Committee, the C&AG noted that the Government’s proposals at that stage were “...practicable”, and he highlighted that “...it is as much about implementation as about concept”. (HC 763, 2010–12). No audit model is, in itself, perfect. Success depends upon well managed implementation and, once in place, the existence and effective operation of appropriate safeguards. Likewise, no system of external audit can of itself prevent service or operational failure. With this in mind, we offer some specific observations below.

*Safeguarding the independence of locally appointed auditors*

17. At his appearance before the CLG Select Committee, the C&AG highlighted the external auditor’s independence as one of the underpinning Principles of Public Audit. The C&AG drew on his experience in the private sector to emphasise the important and well-established role played by Audit Committees with independent membership.

18. In our discussions with local authority staff and members we have noted concerns around the Government’s proposals for “Independent Auditor Panels”. These include:

   — The availability of sufficient suitably qualified independent members.
   — The interface with existing arrangements where independence and challenge is underpinned through roles for opposition council members.
   — The risk posed to the auditor’s discretion by the prospect of the Independent Auditor Panel providing advice when the auditor is considering whether to issue a public interest report.

19. We consider that the Government should reflect carefully on its current proposals for Independent Auditor Panels. It should assess whether scope exists for a more practicable solution, building on existing Audit Committee arrangements, and consider preserving a role for elected council members alongside additional independent input, to safeguard the independence of locally appointed auditors.

*Other local bodies within the proposed audit framework*

20. The current Commission framework covers not only local government bodies, but also a range of others including police and some local health bodies. The draft Bill does not as yet include any proposals regarding arrangements for the audit of local health bodies. To facilitate effective pre-legislative scrutiny, it is imperative that Government develops firm proposals covering the entirety of local bodies which will fall within the proposed audit framework.

*Future regulatory structure*

21. The draft Bill sets out the proposed arrangements for regulating the work of local auditors, from standard setting via the Code (to be done by the NAO) through to eligibility criteria for the conduct of audits and the monitoring of audit quality (to be carried out by the Financial Reporting Council (FRC) and the professional accounting institutes). Proposals in the Bill for auditor eligibility and monitoring of audit quality have the benefit of building upon arrangements already in place for the audit of companies.

22. The FRC and professional institutes will be familiar with the nature of much of the audit work carried out on local public bodies. A large part of the financial audit of local bodies’ annual accounts will be similar to that carried out on private sector bodies. Other aspects of the work, though, will be different—for example, the audit of local authority specific accounts schedules and disclosures, and the requirement on auditors to consider arrangements to secure value for money. The monitoring of audit quality must be tailored to meet the requirements of public audit and the FRC and professional institutes need to be able to draw upon appropriate expertise to carry out their important work.

*Other issues to be resolved*

23. Though the draft Bill is extensive in its coverage, there remain gaps when compared to the Commission’s current activities. The Government needs to do further work to decide whether similar work will be required in the future and, if so, to whom the responsibility should fall. Examples include the different elements of the Commission’s work on fraud (eg the National Fraud Survey and the National Fraud Initiative), the corporate governance inspection team which the Commission has retained, and the extensive information which the Commission has collected routinely to inform its value for money profiles and intelligence gathering.
Managing the transition

24. Getting the legislation right is of paramount importance but, as the C&AG indicated in his evidence to the CLG Select Committee, implementation of the Government’s proposals will be key. To that end, it will be important to apply best practice programme and project management disciplines to the transition phase—especially in view of the increased number of bodies with a potential role in the future audit framework (both different government departments and other bodies). An added complexity is caused by the likely differential timing of key events (Commission closure—March 2015; expiry of the existing Code of Audit Practice—March 2015; and the end of existing outsourced audit contracts—2017 with the possibility of up to three year extensions).

25. Whilst recognising that responsibility for implementation rests with DCLG, the NAO is keen to assist and stands ready, subject to Parliament’s approval, to play its part in the transition to the new arrangements.

October 2012

Memorandum submitted by the Department for Communities and Local Government (Points of Clarification to the Committee)

ACTION 1: OFFICIALS TO PROVIDE A NOTE FOR COMMITTEE MEMBERS SETTING OUT HOW THE ACCOUNTANCY REQUIREMENTS HAVE BEEN CHANGED IN THE DRAFT BILL AND THE BENEFITS OF THIS

Proposals in the draft Bill

— Clause 2 of the draft Bill requires relevant authorities:
  — to keep adequate accounting records; and
  — to prepare a statement of accounts in respect of each financial year.

— Clause 82 gives power to make Accounts and Audit Regulations to fill out the Clause 2 duties.

Current requirements

— Section 2 of the Audit Commission Act 1998 requires that the accounts of audited bodies “shall be made up each year to 31 March or such other date as the Secretary of State may generally or in any special case direct”. In addition the Accounts and Audit Regulations 2011 (SI 2011/817, made under s27 of the 1998 Act) require all the local government bodies covered by the Act:
  — to maintain accounting records meeting the requirements set out in the regulations;
  — in the case of larger bodies to prepare an annual statement of accounts; and
  — in the case of smaller bodies to prepare an annual statement of income and expenditure or receipts and payments.

Explanation for the changes

— The draft Bill removes the duty to make up the accounts at the financial year end. This duty reflects the practice in earlier times of keeping accounts in books; at year end the accounts were totalled and the annual statements (the summary fund accounts and the balance sheet) written into the books—this was the process of “making up”. With the use of computerised accounting systems this requirement has become outdated. The annual published statements are now entirely separate from the records of accounting transactions that are maintained day to day and are the source of the figures shown in the published statements. Even the smallest bodies, which may continue to keep their accounting records in a bound book, have to prepare a separate annual statement under the limited assurance framework.

— In place of the duty to “make up,” the draft Bill:
  — brings into primary legislation the duty to keep accounting records; and
  — requires all authorities to prepare an annual statement of accounts separate from the records.

— This follows the model of provisions on accounting in the Companies Act 2006 and the Charities Act 2011. It also reflects actual current practice in the relevant authorities, and does not amount to a new requirement because the duties in the Bill effectively reproduce duties currently in the Accounts and Audit Regulations.

— In summary, the aim of Clause 2 is to establish a modern legal framework for local authority accounting processes, putting the key requirements in primary legislation and allowing details to be set out in regulations.
ACTION 2: OFFICIALS TO PROVIDE A NOTE FOR COMMITTEE MEMBERS ON PUBLIC INTEREST REPORTS AND COST RECOVERY UNDER THE CURRENT AUDIT REGIME AND THE FUTURE REGIME.

— In the current system, all duties are considered part of the audit function and so fall within the audit fee framework. The Audit Commission Act 1998 requires the Audit Commission to set a scale of fees in consultation with relevant associations of audited bodies and representatives of the accountancy profession. If it appears to the Commission that the amount of work involved was substantially more or less than that envisaged by the scale, such as where an auditor has undertaken a public interest report, it may charge a fee which is larger or smaller than that on the scale.

— It is for the auditor to determine the work necessary to complete the audit and in practice, the auditor will seek to agree the audit fee with the audited body. In law, the fee is determined by and payable to the Commission itself although in practice the audit firms collect the fees on the Commission’s behalf.

— The draft Local Audit Bill does not propose a centralised fee scale: it will be a matter for the authority concerned and the auditor to agree the audit fee.

— The draft Bill retains the duty for local auditors to consider whether it is necessary to make a report in the public interest about any matter coming to the auditor’s attention during the course of the audit. Although work on Public Interest Reports and dealing with objectors has traditionally been treated as part of the chargeable audit work, for the avoidance of doubt, specific provision is made in respect of the recovery of costs incurred in the preparation of such public interest reports (clause 63(5)) and in connection with the issue of advisory notices (clause 78(4)). In both cases they are recoverable by the auditor from the authority concerned.

— The draft Bill does not include any specific provision for recovery of costs or expenses incurred in any investigations or preparations that do not result in a report being made or a notice being issued, save so far as they will be recoverable as part of the costs of the audit, as currently. Neither is specific provision made for the recovery of costs incurred in considering objections made by local electors under clause 75 of the Bill.

— We could consider including provision for recovery of such costs in the draft Bill.

ACTION 3: OFFICIALS TO CLARIFY THE NUMBER OF STUDIES UNDERTAKEN BY AUDIT COMMISSION AND THE SECTORS WHICH NAO CAN CURRENTLY DO VALUE FOR MONEY STUDIES ON

— The Audit Commission has produced 730 reports on local government and health since 1984. It published 16 national studies in 2009–10 relating to local government and health—these included value for money studies.

— The National Audit Act 1983 enables NAO to conduct national value for money examinations as part of holding Government departments to account to Parliament. The National Audit Act 1983 provides powers to the Comptroller and Auditor General to carry out examinations into the economy, efficiency and effectiveness with which any department it audits has used its resources in discharging its functions; and similar examinations relating to bodies that receives more than half its income from public funds and which is appointed (or whose members are required to be appointed), by or on behalf of the Crown. The NAO also has powers to conduct value for money studies on any body required to keep accounts under the National Health Service Act 2006, and any NHS foundation trust.

— The draft Local Audit Bill amends the National Audit Act 1983 to provide a power for the Comptroller and Auditor General to undertake further examinations into the economy, efficiency and effectiveness with which any department it audits has used its resources in discharging its functions; and similar examinations relating to bodies that receives more than half its income from public funds and which is appointed (or whose members are required to be appointed), by or on behalf of the Crown. The NAO also has powers to conduct value for money studies on any body required to keep accounts under the National Health Service Act 2006, and any NHS foundation trust.

— The draft Local Audit Bill defines English local authorities as:
  — A county council in England.
  — A district council.
  — A London borough council.
  — The Council of the Isles of Scilly.
  — The Common Council of the City of London in its capacity as a local authority.
  — A metropolitan county fire and rescue authority.
  — The London Fire and Emergency Planning authority.
  — A fire and rescue authority in England constituted by a scheme under section 2 of the fire and rescue services act 2004 or a scheme to which section 4 of that act applies.

— The draft Local Audit Bill does not place a limit on the number of additional examinations that the National Audit Office would be able to undertake, but the accompanying narrative explains that the National Audit Office envisages undertaking a small programme, increasing to six studies covering local government in 2014–15. The National Audit Office would have to secure the budget for undertaking these studies from The Public Accounts Commission, which approves the National Audit Office’s annual strategy and budget.
**Action 4: Officials to Provide a Note on Savings to be Achieved on Abolition of the Audit Commission**

- The draft impact assessment estimates the total savings over ten years (2010–11 to 2019–20) as £1.151 billion. £650 million of this will be realised in the next five years (2012–13—2016–17). These figures are the net present value of the savings—ie they have been discounted to give the total value of the savings today.

- This £650 million saving can be broken down as below:

  **Savings from:**
  - End of CAA/inspection and associated compliance costs: c £200 million.
  - Reduction in direct cost of audit: c £260 million.
  - Reduction in Audit Commission overheads: c £165 million.
  - Audit Commission ending payments to external researchers, contractors and consultants: c £60 million.

  **Costs from:**
  - transitional liabilities c £35 million.

- These savings will be realised with a residual Audit Commission still in place until 2015. The scope of audit under the new framework will remain exactly the same.

- The Audit Commission confirmed to DCLG that it was confident that the lower fees secured under the outsourced contracts were sustainable, and would not negatively impact on the quality of audit over the lifetime of the contracts.

**Further Points of Clarification**

- On Tuesday 30 October, the Committee held its first evidence session on pre-legislative scrutiny of the draft Local Audit Bill. Please see below clarification of statements or queries raised in discussion at this session.

**Publication of Auditor Appointments by local bodies**

- Part 3, clause 7 (2) of the draft Local Audit Bill sets out a duty on relevant authorities to publish the details of an auditor’s appointment within 28 days of the appointment being made.

- In addition the auditor’s name and contact details will be given in the annual notice announcing the date from which the auditor can receive objections; this is currently a requirement of the Accounts and Audit Regulations, and a similar provision would be required under the new legislation. In accordance with Auditing Standards, the auditor’s name and contact details are also given in the audit opinion on the accounts, and the accounts are available on the authority’s website, and this will stay the same under the new regime.

**Whistle blowing Legislation**

- The draft Local Audit Bill will not change the existing power to prescribe persons to whom a public interest disclosure can be made. Currently the Audit Commission and its auditors are so prescribed in the Public Interest Disclosure (Prescribed Persons) Order 1999. The final Bill will make consequential amendments to designate local auditors as prescribed persons.

**November 2012**

**Additional memorandum submitted by the Department for Communities and Local Government**

At the committee session last Tuesday, I promised that I would write to you with further details of the provisions for appointing and removing auditors for police bodies in the draft Bill and the savings achieved from abolishing the Audit Commission. Detailed information on both points is enclosed in Annex A.

Like councils, Police and Crime Commissioners are democratically elected and will take advice on auditor appointment from an independent auditor panel. They will be responsible for appointing an auditor that will scrutinise both the Police and Crime Commissioner and the Chief Constable for the relevant area. I am satisfied that these provisions are in line with the principles proposed for other local bodies, and these have been agreed with the Home Office.

The impact assessment shows that the total annual cost of the audit regime in 2014–15 (the final year of the Audit Commission) will be £85.1 million and the total annual cost of the new regime in 2018–19 (once the new arrangements have bedded in and local authorities are appointing their own auditors) is £82.73 million.

I maintain that closing the Audit Commission is an important step in refocusing local audit on helping local people to hold councils and local public bodies to account for their spending decisions. I see no reason why local bodies should not appoint their own auditors and, as I said in my evidence, I am open to your suggestions.
as to how we might strengthen the Bill in some areas and ensure maximum flexibility for local bodies whilst safeguarding auditor independence.

I look forward to reading the recommendations in your report.

Annex A

APPOINTMENT AND REMOVAL OF AUDITORS IN RELATION TO POLICE AND CRIME COMMISSIONERS

1. Like other local bodies, Police and Crime Commissioners will be required to appoint their own auditor, having taken into account advice from an independent auditor panel. As requested by the Home Office, the Bill requires that the auditor appointed to audit the Police and Crime Commissioner’s accounts will also audit those of the Chief Constable for the relevant area. This approach will also apply in London, where the Commissioner of the Police of the Metropolis will be audited by the auditor appointed to the Mayor’s Office for Policing and Crime.

2. The draft Bill includes powers to make provisions on the process for removing an auditor. As set out in the policy narrative published alongside the draft Bill, we intend to require that any decision to remove an auditor is subject to the advice of the auditor panel. A body wishing to remove its auditor would need to provide a statement of reasons to the auditor panel. As with the appointment decision, we expect that if a body does not follow the advice of their auditor panel with respect to the removal of an auditor, they will need to publish a statement on the reasons why.

3. We have developed these proposals in discussion with the Home Office and all other departments that are responsible for the local public bodies covered by the draft Bill (the draft Bill gained clearance across Government before we published it in July 2012). We will continue to work with Home Office colleagues in developing the relevant secondary legislation to consider if any variations are needed to reflect particular arrangements for police bodies.

REMOVAL OF A CHIEF CONSTABLE BY THE POLICE AND CRIME COMMISSIONER

4. The removal of a Chief Constable by a Police and Crime Commissioner is subject to the checks and balances set out in the underpinning legislation, as well as those in public law requiring the Police and Crime Commissioner to act fairly and reasonably. The Police (Amendment) Regulations 2011 specify the procedures to be followed where an elected local policing body (a Police and Crime Commissioner or the Mayor’s Office for Policing and Crime) proposes to call on a chief officer of police to retire or resign, or a chief officer proposes to call on a senior officer to retire or resign, on the grounds of poor performance or misconduct:

— The Police and Crime Commissioner must first obtain the views of the Chief Inspector of Constabulary regarding the removal of a chief constable and must provide this, along with his or her own reasons to the Police and Crime Panel and the Chief Constable concerned.

— The Police and Crime Commissioner must give the Chief Constable the opportunity to make written representations about the proposal to call for their removal.

— The Police and Crime Panel will then hold a scrutiny hearing to consider the matter and will publish its recommendation.

— The Police and Crime Commissioner must then consider the panel’s recommendation and notify the panel of his or her final decision.

SAVINGS FROM ABOLITION OF THE AUDIT COMMISSION

5. The £650 million saving can be broken down as follows:

Savings from:

— End of Comprehensive Area Assessment/inspection and associated compliance costs: c.£200 million.

— Reduction in direct cost of audit: c.£260 million.

— Reduction in Audit Commission overheads: c.£165 million.

— Audit Commission ending payments to external researchers, contractors and consultants: c.£60 million.

Costs from:

— Transitional liabilities c.£35 million.

6. The impact assessment shows that the total annual cost of the audit regime in 2014–15 (the final year of the Audit Commission) will be £85.1 million and the total annual cost of the new regime in 2018–19 (once the new arrangements have bedded in and local authorities are appointing their own auditors) is £82.73 million. The cost of the new regime includes estimates of the regulatory costs incurred by the National Audit Office and the Financial Reporting Council and professional bodies and the cost of the National Audit Office undertaking value for money studies. Local bodies’ compliance costs of £4.4 million are also factored into the total cost of the new regime.
7. We consider that the regulatory costs in the new framework will be no greater—and should be less—than those in the current Audit Commission regime. Based on figures provided by the Audit Commission, we have estimated that the total regulatory costs in the final years of the residual Audit Commission will be £4 million per annum and the impact assessment assumes no savings from regulatory costs in the new framework. We have therefore estimated that regulatory costs in the new framework will also be £4 million pa. This comprises the National Audit Office’s costs to set the code of audit practice, which for the purposes of the draft impact assessment we have assumed to be £2 million pa, and the Financial Reporting Council’s and professional bodies’ regulatory costs, which are included in the audit fees paid directly by local bodies to their auditor and we have assumed to be £2 million pa.

8. The National Audit Office estimates that the value for money studies undertaken by them will cost roughly the same as they currently do (approx £300k each—a total of £1.8 million pa), but the new programme of value for money studies will be smaller in number and better targeted than the Audit Commission’s has been—resulting in a saving of £3.2 million per year.

9. The impact assessment may not, however, show the full extent of the savings as it does not assume that audit fees will go down in the new framework and shows them remaining at the same level as under the outsourced contracts. While we believe that audit fees will go down once local bodies start to appoint from an open and competitive market—a view shared by several witnesses from local government, audit firms and regulatory bodies—we have not estimated by how much. We are also aware that the contracts for 30% of the audit work that were let in 2006 and 2007, and are due to expire in 2017, do not represent the same value for money as the contracts that were let earlier this year (Michael O’Higgins alluded to this in his oral evidence) and there may be further room to find savings when those local bodies start appointing their own auditors.

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