Evidence heard in Public Questions 1–71
Oral Evidence

Taken before the Public Accounts Commission

on Wednesday 7 December 2011

Members present:

Mr Edward Leigh (Chair)
Mr Richard Bacon
Margaret Hodge
Mrs Anne McGuire
John Pugh

Examination of Witnesses

Witnesses: Amyas Morse, Comptroller & Auditor General, Sir Andrew Likierman, Chair, NAO, and Michael Whitehouse, Chief Operating Officer, NAO, gave evidence.

Q1 Chair: Good morning and welcome to the Public Accounts Commission. We welcome back Sir Andrew Likierman, Amyas Morse and Michael Whitehouse. You are very welcome. We are here today to ask you some questions about your strategy. Mr Morse, I think we would quite like to start straight away with the Treasury letter, if you do not mind, of which, I understand, a copy has been sent to you.

Amyas Morse: Yes.

Chair: You know the points that they have been making. I will repeat it for the record. They are basically repeating that, as we know, we are in extraordinarily difficult times. The Treasury letter quotes the Chancellor about us having a highest structural budget deficit of any major economy in the world. They go on to point out that you are reducing costs by just over 14% in cash terms, which is a net reduction of 9.6%, but they then go on, as the Treasury often does but are quite entitled to, to say that they are not a dissimilar size to you but they are reducing their administration costs by 26%, whilst taking on substantial new responsibilities. What do you say to them, Mr Morse?

Amyas Morse: I shall ask Michael Whitehouse to amplify, but probably the most significant point the Treasury makes—when we come to it, I will ask Michael to talk about the overhead costs—is about the illustrative year, where we show an uplift in the level of pay that we anticipate having to give. That is, of course, only illustrative at the moment. We are not asking the Committee to agree to it. As a matter of fact, we put this strategy document together before we had heard the Government’s latest announcement about the 1% freeze.

Q2 Chair: I was going to ask you about pay in a moment, but I would like to keep the two separate.

Amyas Morse: It is a big cost driver and it is one of the major subjects that the Treasury is actually speaking about. Let me ask Michael to comment on the overheads.

Michael Whitehouse: If you go back to when we were before the Commission last year, we went on the record to say that we had a strategy to reduce our overall spending by 15% over three years, starting with 2010–11 and going forward to 2013–14. We advanced that strategy and, as the Treasury acknowledge, last year we surrendered back to the Exchequer £3.5 million. What we were doing in that first year was to accelerate our approach
to producing savings in running costs. I do not disagree with the Treasury, but you do need to take into account that, in addition to what they are saying, we did advance the saving and deliver £3.5 million last year, and I can explain how we did that.

I would also refer you to figure 9, which is on page 29, I think, of our strategy. There, this shows our net resource requirement over the four-year period. If you look at the difference between 2010–11 and 2014–15, if you do not take into account the additional bid that we are making for new responsibilities arising out of the Audit Commission, in real terms we will be making savings of around 19.8%. I am not trying to confuse you with figures, but I think you do have to compare with the right year.

Chair: No, we would never expect you to do that.

Q3 Margaret Hodge: 19% is less. Figure 9 is a useful figure, but 19% is less than is being demanded of other organisations.

Michael Whitehouse: Again, two points I would say on that: I think it is variable across the whole of the public sector. Some departments are not delivering on that level of saving.

Q4 Chair: Some departments are cutting 30%.

Michael Whitehouse: Some departments are cutting 30%.

Q5 Margaret Hodge: Which are not doing 30% of the central admin costs?

Michael Whitehouse: There were some departments that were smaller. I do not have the figures.

Q6 Margaret Hodge: They are all taking money out of central admin costs. Even DFID are taking a third out of their central costs. Indeed, we have been a bit critical of that, at the time of an expansion. These are back-office-style costs. I cannot think of a department. Perhaps Richard can.

Michael Whitehouse: Perhaps if I could amplify on that point as well. If you look at our corporate cost, which is the equivalent of back-office functions, and you look at our figures, since 2006 we have reduced our corporate service numbers by 24%, which is broadly in line with that. The difference where we are not reducing the expenditure as much is in our frontline activity, and part of our strategy has been to remove more of our corporate-service people, to identify savings and put those savings into the frontline. As a final point, I would say that what we need to be very mindful of is the fact that Government is going through major change. It is reducing its cost base but, at the same time, it is reforming the way in which it delivers public services.

Q7 Chair: That always happens, Mr Whitehouse, in any period of history. There are always major changes. There are always changes of Government.

Michael Whitehouse: I would say that, then, in that instance, the judgment that we had to take as a Board and a leadership team was to identify the cost reductions that would be legitimate and appropriate, while still maintaining a level of audit service that enabled Parliament to scrutinise—

Q8 Chair: In the last 15 years, we have had very large increases in public spending—55% in real terms—so you could have equally argued that put enormous pressure and, therefore, you would have to have commensurate increases in your budget, so we cannot win either way, can we? Precisely when Government is cutting, you are the one department that is not under the thumb of the Treasury. You are the one department who is, in effect,
independent, and I think we want to be absolutely convinced that you are making extraordinarily tough and difficult decisions to try to set an example to the rest of Whitehall.

Michaël Whitehouse: Coming back to the point that I just summarised, as I said, our corporate back-office functions have reduced by 24% since—

Q9 Margaret Hodge: Yes, but everybody else is 33%. Audit in local government is going down. We looked at it the other day: the audit function was about a third, if not more. Treasury, which has the role in Government to do what we are trying to do in holding it to account, is going down by... I cannot remember what the letter says.

Mrs McGuire: 26%.

Michaël Whitehouse: I stand by the point that we formed a judgment as to what is needed to do an appropriate audit.

Q10 John Pugh: I was just going to draw your attention to section 6 of the letter, because, when I read it, it is a covert accusation, isn’t it? It says that it is welcome to find that the NAO have unerringly underspent the estimate provision by some £3.5 million. The Commission may like to satisfy itself that this achievement came about by deliberate cost-saving measures and not just because the NAO sought and obtained more provision than needed. Lest we did not get the point, they added that the standard for estimate of the Treasury is to achieve taut provision without hedging. Is that a fair accusation? Basically, what they are saying is you overegg your original estimate by £3.5 million.

Amyas Morse: Yes, I understand that.

Michaël Whitehouse: I do understand, and the Treasury have a legitimate role in challenging us.

Q11 John Pugh: It is not true?

Michaël Whitehouse: Not true. I can give you some figures, and you can judge this for yourself. If you look at the average study costs for VFM, they were £298,000 in 2009–10, and 2011–12 is on target for around about £225,000 for average cost of study. The reason we have been able to do that is because we have changed the operating model within the NAO to make it more efficient, to place less reliance on outsourcing, to introduce better techniques and standardisation, and to bring in many of the private-sector approaches that will help drive down costs. Similarly on financial audit.

Q12 John Pugh: When you put the original estimate in, you had not made a decision to change all these procedures or take out pictures off the front of brochures and the like.

Michaël Whitehouse: We were exercising a degree of caution.

Q13 John Pugh: Exercising a degree of caution.

Amyas Morse: Because we actually did not know the rate we could go at... If you just consider those numbers, that is a very considerable reduction in the average cost, and we did not know that it would happen that quickly—that we would drive down on it and we would achieve so much so quickly. Having achieved it, I felt we should hand the money back. Instead of saying, “Look, somehow this will remain on budget,” I thought, “No, we have actually achieved this efficiency faster than we thought; we will hand the money back.” For that to become a demerit, I think, is very surprising.

Q14 Margaret Hodge: One of the reasons the costs have gone down is you are doing more short inquiries, which I welcome, so it is not entirely a cost-per increase; it is the nature of the beast you are undertaking.
Amyas Morse: Relatively not that many of them. There are a few. Bear in mind the vast majority of what we do as auditing is financial audit. There are 60 value-for-money reports and, out of those, the short-term population is under 10, I would say, in a year.

Q15 Margaret Hodge: Six months rather than a year?
Michael Whitehouse: The figures are that 86% are delivered in less than nine months and 13% less than six months, so the smaller ones are still a small proportion. The other point, I think, that is worthwhile making is that, when you are looking at your operating model and you look at a VFM study, you really want to focus on those areas that are going to add most value. I would argue that where you get a better product from us is where you get really in-depth analysis. What we have been very careful to look at is, as you reduce cost on a VFM study, you do not reduce the analytical content of the fieldwork. What you do reduce is the planning and all the associated costs that go with that. The audit fieldwork is the most expensive, because you have to use a whole range of different forensic approaches, particularly in a more localist approach to delivering public services.

Q16 Margaret Hodge: Can I ask three questions following on from that? One, you have reduced your use of consultants by how much in terms of a trend over time?
Michael Whitehouse: I have the figures here, but if you could just bear with me.
Amyas Morse: In fact, they are not consultants. Can I just be clear with this? What we are talking about is there has been a percentage of our work resourced by contracting out some of the primary audit work. What we have done to work our own resources more efficiently is taken more of that in-house. To get more throughput out of our existing staff, we have actually brought it in-house. So to describe it as consultancy work risks being misleading. It is not what it is.
Sir Andrew Likierman: Chairman, can I just add, because Michael has not yet found the figures, that, as a Board, what we have tried to do is to say, “Let us look fundamentally at our processes, not just reduce costs on the basis of the current model.” Going back, if I may, to Mr Pugh’s point, what we have tried to do on a continuous basis is to say, “Let us look at everything we are doing and make sure this is the right thing to be doing, as well as the right way to be doing it, on the basis of assumptions we have previously had.”

Q17 Chair: What have you actually changed? We created this Board. We are the Commission. We have to ultimately approve your budget and your strategy, but you are much more hands-on. What have you actually changed with this organisation? How much of these savings can be credited to you?
Sir Andrew Likierman: Of savings directly?

Q18 Chair: Yes, to you, to the Board. How do you grip this organisation and demand that Mr Morse achieve the kind of cost savings that other departments are coming forward with?
Sir Andrew Likierman: If I can go to a very precise area, in terms of the benchmarking that we are doing now, one of the things we have been doing is exactly that, which is to say, “Let us compare not just where we are now to where we were before but where we are now compared with others,” and again there seems to be a benefit to bringing in this outside focus, from the Board’s point of view. Of course, I would like to claim all the credit for the Board for everything that has happened, but that would be overegging it. What I had hoped we can do is look at it from the point of view of the stakeholder, which is, I think, the idea that this Committee and Parliament had, to make sure that the stakeholders’ interests
were represented on the Board and to make sure that we knew where Parliament’s interests lay in the way that has happened before.

Q19 Chair: That is a lot of words, Sir Andrew, but I am not sure you have actually said anything yet. You have mentioned others, so what others? What have they done? What are they doing? Give us examples.

Sir Andrew Likierman: I take the example we have had already of other Government departments. We have also been looking at the way in which private-sector organisations have been driving down costs and looking at their models. We have been looking at the way in which other parts of the public sector have been doing it. Again, every time we, as a Board, get proposals to come forward, what we hope to do is to bring that outside perspective to bear on it. As I say, if there were not these outside members, I believe there would not be as much of that outside perspective.

Q20 Margaret Hodge: The other one was: how many people in the NAO are paid at Permanent Secretary level and up?

Michael Whitehouse: The figure I can give you, if you take those above the Prime Minister, is that there are three of us within the organisation. I do not know exactly what the range is for the Permanent Secretary, but I can tell you the broad ranges of salary for NAO staff.

Chair: Actually, we can go straight on to pay, then, because this is also Treasury—

Michael Whitehouse: Could I just answer Mrs Hodge’s question?

Chair: Sorry, I do apologise.

Michael Whitehouse: You asked about outsourcing. In 2009, the outturn was £17.5 million. For this year, we are projecting an outturn of about £13 million. The majority of that reduction has been on value for money because, on financial audit, the model is predicated on the basis that a proportion of our work will be contracted out to the private sector first, because that enables us to benchmark our own costs within the organisation. You can see a general trend down. By 2014–15, our projection is around about £12 million of our work will be outsourced to the private sector.

Q21 Chair: On pay, again going back to the Treasury letter, the Chancellor has just announced a cap on public-sector pay awards at an average of 1% for each of the two years after the pay freeze ends, yet the NAO proposes to raise base pay as soon as 2012–13, when public-sector pay will generally remain frozen. What is your answer to that, Mr Morse?

Amyas Morse: The problem we have, to be quite clear, is that we are competing in a market for accountants. We do not want to pay any more than we have to, but we already are losing staff at a higher rate than planned, because they are being hired by private-sector accounting firms. We cannot not have accountants, but if we are going to keep our staff and be able to carry out the work that we need to, we have to keep a certain relationship. We do not need to go all the way up to the private-sector market, but we need to keep it in mind. We are not in a position where we can simply say, “We will ignore that,” or we are going to have large numbers of people walking out of the door. The difficulty is they are highly marketable.

Q22 Chair: Graduate unemployment is very high at the moment. Are you just not having good candidates coming forward? For graduates, what are you paying at the moment?

Michael Whitehouse: Can I answer two questions first? You also have to look at your turnover of staff. Where we are most vulnerable is on qualification, so, since April of this year, we have lost 28 audit principals, which is the first grade post-qualification.
Q23 Mr Bacon: That is out of a cohort of how many? You take 80 a year, don’t you?

Michael Whitehouse: Yes.

Q24 Mr Bacon: Is that 28 out of 80?

Michael Whitehouse: Less than that—it would be around about 20. Some of them may have been here two years, the majority for three. A better indicator would be to say the operating model is assuming turnover, to make it viable, of 15%; at the moment, it is running at between 19% and 19.5%. They are largely going to the financial institutions and, believe it or not, some of the banks. We are losing some people to the banks.

Mr Bacon: We know from the Treasury, who told us this the other day, that the Treasury is losing staff at a much higher rate. They have a turnover of 28%. That, perhaps, is a reflection of the fact that they are being more stringent in their pay. I do not know, but I take your point.

Q25 Mrs McGuire: Could I ask if you think the Treasury comment about graduate unemployment is a general comment about graduate unemployment and not a specific comment about the employment prospects for those young people coming out with accountancy qualifications? I suspect, Mr Leigh, there is a generalisation in here, seeking to support a greater hypothesis.

Michael Whitehouse: Yes. I think it is still a very competitive market for people going into the accountancy sector, particularly when the big firms are continuing to recruit and are increasing their recruitment. We watch very carefully—as much as you can get that information, because it is obviously commercially sensitive—what is going on in the market. Just to give you an example, you asked particularly about the salary levels. For example, the London minimum for an assistant auditor, which is our basic entrance grade, is around about £25,000. That compares reasonably with the private sector, and you can go up to a London maximum of about £33,000.

Q26 Chair: Is that where they start?

Michael Whitehouse: Yes.

Q27 Chair: I was talking to a young man at Durham University on Sunday, who is going to KPMG, and he is starting on £22,000.

Michael Whitehouse: It varies where in KPMG he is starting, whether it is London, but all the figures are competitive.

Chair: In London, yes.

Michael Whitehouse: Where it does begin to diverge is, for example, when you become an audit manager; our London minimum is around £55,000 and the maximum is £74,000, and the minimum with one of the big firms is £60,000, going up to £120,000.

Q28 Chair: We have always had this problem, though, because you give people a fantastic opportunity, don’t you—a start in life? The world is their oyster. You have always had this problem, haven’t you? We have had these conversations with your predecessors.

Amyas Morse: We have, but it is quite important to remember something, and it goes to the earlier point: we are carrying out activities to certain standards, to financial auditing standards and to international standards. As far as the financial audit side is concerned, we have to use qualified staff. They have to carry out certain procedures. It is not a question that we can decide, “We will not bother to do them.” We can try to organise it as efficiently as possible, but an awful lot of what we do is to audit a large part of the public sector. We just
have to have qualified resources to do that; otherwise, we will not be able to complete the audits.

With regard to VFM, we have been pressing and achieving efficiencies, but I would not like you to get the impression that those efficiencies will just go on and on. There is a point at which we cannot take more resource out of delivering a financial audit, and there is a point at which we cannot take more resource out of doing value-for-money studies, because you have to go in and gather the data to be able to do those studies. It is just not feasible to do it without a certain degree of qualified resource going out there. I do not want to give the impression that there is a long road running where we can take the resources down and down. That is not what will happen. We have pressed hard on it and we have achieved results quite quickly, but I do not think that is an infinite pathway.

Q29 Margaret Hodge: I was going to ask Sir Andrew: where are you pressing on?

Sir Andrew Likierman: We are pressing everywhere. In terms of the spirit in which these things are being done, there is nowhere that we are not pressing. Going back to Amyas’ point, a reduction of 33% on a financial audit is much more difficult than something that is much more discretionary, and that, I think, is the dilemma we face. What we do not want to do is to have something that reduces the quality of what we are presenting to Parliament. There is always some trade-off involved in this, but I feel that the importance of maintaining something that is a quality product for Parliament is critical in maintaining the confidence in what the NAO does.

If I can go back to the issue of graduates and the intake, I am very interested in the quality of people who come in, because one of the things that I am determined to do is to make sure that the perception of the NAO as a place that is good to work in and a place where people want to make their careers is better in the future than it has been in the past, and that is something that the whole of the management team is concerned about. We want good-quality people to come in and we want them to do first-class work.

On the business, then, of that trade-off, what we are trying to do is to try to say, “Let us maintain the quality but let us look at everything which is discretionary,” back to the business of looking at the basis of the model. That, I think, is something to which I hope the Board does add value.

Q30 Mr Bacon: When you are recruiting, are there characteristics that you look for in potential recruits that, in some sense, a private-sector firm might not look for? I am talking about public service in the broadest sense, because there are lots of people who go and do things, including many in this building, who could do things elsewhere that would be more remunerative, but they do not, and there are lots of reasons why they do not, even though they could. I am really asking about the character of the people you are hiring. What is it that you are looking for that, say, KPMG or Deloitte might not be looking for?

Sir Andrew Likierman: I think Michael ought to answer that, since he’s involved directly and I am not.

Michael Whitehouse: I think we put a big premium on the public-sector ethos: “Why is it that you want to join the NAO? Is it because you want to add value to the public sector?”

Q31 Mr Bacon: The trouble is that words like “public-sector ethos” and “add value”, which is a lovely management-speak phrase, are so plasticated now that they almost mean nothing. I remember encountering the public-sector ethos coming out of their local authority once at 4.15 on a Friday, when I was met by this tidal wave of people. I said, “What is wrong? Is there a fire?” and they said, “Oh, no”—because I thought the office was open until five—“We all knock off at quarter past four on a Friday.”
Mr Bacon, it is not like that, and please let Amyas respond.

Amyas Morse: No, it is not. There are two things to say. First of all, our people are driven—

Chair: We are getting a bit wide.

Margaret Hodge: He knocks off at half past two.

Chair: I think the conversation is getting a bit wide now, so we are not going to have a long, verbose conversation about public-sector ethos.

Mr Bacon: What I am saying is that not everyone is motivated in the same way.

Chair: Let us have one last answer from you, Morse, and then let us close it down.

Q32 Mr Bacon: I was merely asking: what is it you are looking for when you are hiring?

Amyas Morse: Let me answer that. First of all, they are qualifying as professional accountants, not some other general activity, so they have to be motivated to go through a series of exams and, actually, work very hard themselves to be able to work that way, and we are not to be underestimated. Second, they have to be interested in what is available. The perspective of the NAO is, actually, frankly, for me and for my team, absolutely fascinating. You get to look across the whole of Government. You get to understand and throw light on a lot of processes. We talk to the people we are recruiting about this and, if they are not interested in that, we will tell them, “Please do not join us, because this is what we have to offer.” Some people might regard it as dry and boring, but we in the NAO actually find this stuff really riveting and exciting, and that is how we are motivated to do our work. We are looking for people who have that interest in what is making Government run, and what are the issues that are hidden under the surface that we can bring up to light?

Chair: Let us stop it there, because I think we have a lot of questions.

Q33 John Pugh: I have a very specific question—it is very, very specific. You have given us a figure on turnover, which is one part of the equation. I am not asking you for it now, but could you provide us with the figures for applicants per job at various levels, because that will help us form a measured view.

Michael Whitehouse: I would be happy to do that.

Q34 Chair: Can I just ask you one question about the strategy? I read the strategy. It is full of, as Mr Bacon said, management-speak, but I am not really sure what it tells me, because there does not seem to be much new in this. Is this a dynamic organisation that is trying to chart new territory, or is this repeating what it said last year and the year before?

Amyas Morse: Thanks for that question, and the answer is you never find out if a strategy works if you do not carry it out—an old military adage, which I am sure you are familiar with. There are consistent things that we are pursuing over time, and they are working, which is why we are continuing to do them. However, there has been a significant development.

First of all, we have built up a really capable IT team. We have published two reports on IT and we have another three coming up, because it is a major change agent in what is going on in Government at the moment. That is very different to where we were before. We have been very much involved in the launch of the Major Projects Authority. We have had a lot to say about how the project should be run and, indeed, we have also published what we consider to be best practice in launching successful projects. All of that is still in line with the strategy but very different to what it has been before.

We are doing a lot of studies much earlier than we did before, to try to influence the outcome. By “a lot”, I really do mean a lot of studies, and far more of our studies are cross-
cutting across Government. You could say approximately 25 out of 60 studies have a strong cross-cutting element and, of those, 15 are exclusively cross-cutting. That is a very big change in the portfolio from what it was even in the time since you were chairing the PAC, Mr Leigh. The fact that we have a consistent strategy focused on understanding the client’s issues and being driven by them is not a sign that we are static. We are actually reacting to events very fast.

**Q35 Mr Bacon:** Mr Morse, you identified three areas of weakness in looking at Government in your strategy previously: financial management, cost-effectiveness, and the use of information. Can you offer us some evidence of any improvements in those areas in Government since you became C&AG, and examples of where departments’ abilities have improved in those areas?

**Amyas Morse:** If I was putting a RAG rating on it, I would probably give us a variable score in what I can say has been achieved. The least good is on understanding cost-effectiveness. I think Government has least evolved in that area and, even though we are doing a lot of work in terms of performance in trying to help departments in improving in this area, it is the area where I think a) Government has achieved the least, and b) although we have been talking about it, where we have achieved the least purchase. Now it is top of our list.

As far as equality of information and use of information is concerned in changing the structure of Government and in making decisions, I think we are making an impact. It is much more in the front of debate, and you see it constantly being referred to, not just by ourselves but by departments, so I believe we are making some progress there.

Related to that, and probably lying close to the information answer, I think we really have made a lot of headway in improving financial management. Apart from by constantly talking about it, the Chair will know that we have actually published a series of assessments of financial management in the departments. Those have had considerable impact. We do something called a departmental information approach. For every department, every year, we gather together our assessment of the department’s capability, and this is not for publication but it is our internal view of the capability of the department. In looking at that, we have been able to see across a range of measures of performance that most Government departments have improved in their financial management—some very notably, and I would say examples of that most recently, actually, are the Ministry of Justice, with significant improvement there and more to go, and very considerable improvement at the Home Office and also at the Foreign Office. I would put a lot of that down to the pressure and influence that we have applied, although, of course, we are not running these departments. They are running them themselves, so you have to be a bit modest about what you say you have achieved.

**Mr Bacon:** Yes, I appreciate that you are laying out the information rather than being executive in this, but it is interesting you say that the view of financial management is not for publication but is your own private view of department’s capabilities. This Committee has visited the Office of Management and Budget in the US.

**Chair:** Not this Committee, but it does not matter.

**Mr Bacon:** I am sorry, not this Committee—the Public Accounts Committee visited the OMB in the US, and they were very explicit in the way they had a, if you like, RAG rating system—a traffic-light system—across the whole of the Federal Government that was very public. It was pushed from the President of the United States downwards, so that, to give you an example, it would cover things like e-government, human capital, human resources, financial management and so on, and it was very public and explicit. The Department of Justice in the US, in Washington, would have in its foyer its scores, so that all members of staff walking in and out could see how they were doing and where they were.
Chair: Let us get on with it, Mr Bacon, come on.

Mr Bacon: What I am asking is: why is it an internal view? Why is not more widely published?

Amyas Morse: Because it is evolving. The intention is it will become public. This year, I have been open with departments about it for the first time. Because this had not been done before at all, and we started it shortly after I arrived, the quality of information and of analysis is going up—it is getting more credible—so, this year, I have offered private briefings, and I have already done four briefings to departments, where we have had a private session for an hour, talking very frankly about what our assessment of the department was. They asked to have that in addition to more general review meetings. I see this moving up the scale and becoming more and more explicit and clear. By the way, those assessments that I have described go wider than simply financial management.

Chair: Let us go on to the voluntary and private sector. I think Mrs McGuire had a question.

Q36 Mrs McGuire: We have been speaking this morning about driving down costs, and you have been doing that in a context of which you are very familiar—a straightforward public-sector model. How are you going to ensure that, as public services become more devolved and outsourced to both the voluntary and the private sector, when, particularly in the voluntary sector, they may be less focused on value for money and more focused on quality outcomes?

Amyas Morse: We have done some work on this already. We have done some work on mutuals and we have published reports on it, and there are areas I am concerned about, quite frankly. The answer is, “How will we do it?” We will look at the regulatory or the oversight regime that was put in place, or the management regime that was put in place—let us say it is the commissioning boards in health. We will assess what they are seeking to get in terms of information and see if they are actually getting it and, if they are getting it, what it shows.

If you take academies, what we actually found in academies, which is quite a good example for this sort of semi-privatised and charity-run body, was that there is, effectively, a very low level of compliance with making financial returns, although there were other good things about it. That is very concerning because what it adds up to is no-touch rather than light-touch. If that is going on, we will point that out very bluntly and, equally well, if you are going to have mutual-type structures and you are going to start transferring public assets into them, that has to be done properly, with proper account for the custody of public assets. I am uneasy about how much thinking and planning has gone into some of this.

The answer is that there is no structure where you cannot follow down and make sure that the assets are being properly dealt with. Frankly, however much one may be interested in other things and have priorities in other areas, if you are going to use public money there is a minimum standard of accountability you have to be prepared to follow. That is why we have had all the discussions about accountability in the Committee that we have had.

Q37 Mrs McGuire: In terms of the regime that particularly the voluntary sector has operated under, in some ways they would argue that they are more regulated, through the Charity Commission and through the Office of the Scottish Charity Regulator in Scotland and a similar body in Northern Ireland, than the private sector. Have you had any discussions with the Charity Commission and with OSCR in Scotland to look at how you encourage voluntary organisations in particular to move from their current reporting system to something which is linked very strictly to value for money and public assets and accountability for those assets?
Michael Whitehouse: You make some very good points. This is very much work in progress. As Government, as it says it is committed to do, gets more involved in this sector, we want to do more work in this area. I think at the moment we are halfway up the ladder. We need to do more work in this area. I think the points that you raised are certainly things that we are looking at. Amyas gave an example of the academies, which are going by the charity accounting. I do not know enough about it, and we have people in the organisation who are much more informed than I, but the interesting element about it is that there are issues around the extent to which built into it is a VFM element, and that is the sort of thing that we want to explore.

Q38 Mrs McGuire: That is fine for academies, which have been set up recently. We are also talking about a whole range of organisations that have not been set up under the current environment for establishing academies.

Michael Whitehouse: The point I would say in relation to academies is what we can learn from that sector, and whether it is applicable and might be applied more widely. The point is—and I am trying to paraphrase this—that you should not be constantly reinventing the wheel at the centre in Government administration. There are some good things that have worked really well, and we need to learn from those and apply those lessons, so that dialogue is going on. Hopefully, we would like to come back to you in six months or a year to continue this.

Chair: We have a lot of work to do, but Mrs Hodge, I think, wants to come in.

Q39 Margaret Hodge: Is it, therefore, acceptable to you that DWP will not release any information about Work Programme providers for two years?

Amyas Morse: If we asked for information under our statutory authority, I would expect we would be given to access it.

Q40 Margaret Hodge: Will you be able to share that with the Public Accounts Committee? They are refusing to release it to Parliament.

Amyas Morse: If we are doing a study and we are entitled to have statutory access, then it will be another scale of issue if we are denied access. I am not going to pre-judge that, because we have not been denied access so far.

Q41 Margaret Hodge: I will tell you: we are, both as local MPs and as parliamentarians.

Amyas Morse: Let me not sound like I am ducking the issue. As far as I am concerned, I would take a very serious view if we were denied our statutory access.

Q42 Margaret Hodge: The other thing I was going to ask is: when you do these VFM, somebody said to me the other day—you might want to respond to this: I know that you have to get departments to check facts, and I do not know what comfort you can give me on the robustness with which you ensure that departments actually do not take out information that might be of use to us as a Committee when looking at value for money. I was particularly concerned to hear that, when we are doing defence contracts, BAE get to see your draft reports and comment before they ever reach the light of the day. That seems to me a worrying relationship if we are trying to hold to account the expenditure of public money in the private sector.

Amyas Morse: If we are writing a report which makes an evaluation of a performance by a contractor or something like that, it might be reasonable to say, “Have we got our facts right?” but it does not go further than that.
Q43 Margaret Hodge: I was just told that they managed to get quite a lot out that might have been of interest to the wider world. It just seems to me it might be an issue for the Board. It is a bit like all the protocols we were talking about with HMRC, but it will be in their interest to let as little as possible out in the open, and it is in our interests to actually be able to follow the pound.

Amyas Morse: Can I just respond? First of all, I think that is not a matter for the Board, but for me as C&AG, frankly. Secondly, I think you need to just consider the fact that our job is to fairly assess the information, not simply to get as much stuff out as possible; in other words, our job is to fairly assess the information and come to a balanced opinion on it, and then present a report that presents the facts as clearly as we can. That is what we try to do all the time. We do not pull our punches, and why would we? There is absolutely no motivation to do so, but that is not always going to mean the same thing, in that what we present is the same as every allegation that may be made by someone who does not have to support or provide evidence for what they say; we do have to, and that is why our statements have rather more authority.

Q44 Margaret Hodge: I understand that, but if you take the BAE example, you do not have the facility to look into their accounts.

Amyas Morse: If they are published documents, I can look at their accounts.

Q45 Margaret Hodge: You will not be able to really suss out—

Amyas Morse: You need to give me the examples. It is not an example if what you have just done is to make a broad reference. You have not given me an example, and, if you care to do so, I will look into it.

Q46 Mr Bacon: Can I just clarify something? I remember distinctly, in the case of the Bowman radio communication systems, there was a sentence in the Report that said, “The department (Ministry of Defence) agreed that General Dynamics had done everything asked of it”; in other words, it was not the fault of General Dynamics. The fact that Bowman was such a Horlicks was indeed fully on the MOD’s wicket, so to speak. Would it be possible, if you were doing a value-for-money audit of something like Bowman, to have written that sentence without showing it to General Dynamics to be sure that it was factually accurate? Presumably, you would have had to make sure that the contractor was not being misrepresented by checking with the contractor.

Amyas Morse: Either we would have to do that or the MOD. If the MOD were content that this was an accurate representation of the facts, based on evidence they had given us, then we could rely on that.

Q47 Mr Bacon: What Mrs Hodge is saying—this is an important point, Mr Chairman—is that, during the clearance process, people who are suppliers to departments, like BAE or others, have an influence on the clearance process, which is unhealthy. That is, essentially, what she was saying.

Margaret Hodge: Yes.

Mr Bacon: Could you just comment explicitly on that?

Chair: Do answer that, but then let us draw to a close.

Amyas Morse: To be honest, they do not have a formal role in any clearance process, and I cannot imagine, except in very unusual circumstances, where we were relying on technical information, etc, why we would clear something with them, so I really have to know the specifics. I am sorry—I am not being difficult. I really do not know what we are talking about.
Margaret Hodge: It was given to me by somebody. It is one of these things. I have no idea whether it is true.
Chair: Anyway, we have the C&AG and we have the Chair of the Public Accounts Committee—
Margaret Hodge: We can have our talk.
Chair: You can go on chatting.
Amyas Morse: Excellent. Thank you.
Chair: In the way that you always do. Addressing departments’ weaknesses: Richard, do you want to ask any of that?
Mr Bacon: Do I?
Chair: Yes, you said you would.
Mr Bacon: Do I really? Six?
Margaret Hodge: Five and six.
Mr Bacon: I have already done that. What on earth are you talking about, Chairman?
Chair: You do not want to do that—alright.
Mr Bacon: No, I did want to do that; my point is I have already have.
John Pugh: You have. That is done.
Chair: We have done that, have we? John, do you want to talk about the NAO strategy?

Q48 John Pugh: Very quickly, you stated that you also determine the extent to which Departments learn from past experience. Most reports done are, by and large, reports on a single issue, and I think it is left to the Public Accounts Committee to pick up serial offenders and so on. Are you indicating in any way a tendency to move towards something more like the Comprehensive Performance Assessment that local authorities have done on them as a whole, whereby you pick out not just what has gone wrong in this instance but how it may or may not form part of a pattern?
Amyas Morse: No, I am not indicating that, although I did tell you that we do an informal assessment of departments’ capacity on a private basis at the moment. It is rather more. Let me take an example. Members of the Public Accounts Committee will remember that there was a series of failures associated with something called Pathways to Work. When we are assessing the Work Programme—and, by the way, we have a study going on on the Work Programme now, even though it was only launched a year ago, because we are doing a lot of work earlier, as I was saying—one of the things we are looking at is, “Did you learn from what went wrong in the previous, clearly not very successful programme?” It is an entirely appropriate thing if people are going back and reloading, or if they are doing something at all similar. If you have launched a previously failed capital project, you expect to be asked, “Now you are doing another one, have you learned anything? Have you got rid of the optimism bias? Have you actually looked at the alternatives properly this time?” We do find that a very helpful line to take—and, by the way, we also take that line with the MOD.

Q49 John Pugh: In terms of the jungle of data you have to deal with, are you satisfied that departments, as it were, present their projects in a sufficient way to enable you to come to these clear and lucid decisions?
Amyas Morse: No, not always. If you are presented with poor information, you can either say, “We will be put off by that altogether,” or you use your forensic skills to come to the best analysis you possibly can. That may involve sampling. My preferred basis for any study is to base it on hard management information as close to the facts as possible. If that is not available or it is defective for some reason, then you have to find other ways of arriving at
a view of what value for money has been, and that may be sampling, it may be interviewing or it may be taking some hard facts and extrapolating from them. We use a combination of techniques to get to the issue as best we can.

Chair: I think Mrs Hodge wants to ask about the impact of your work.

Q50 Margaret Hodge: Yes, there is this magical figure that appears about “NAO, great savings”, but I do not know what we are at this year. I am very sceptical, really, of the figure. I suppose the question is: are you content with the impact you are having, how would you want to improve it, and what mechanism are you not able to employ but you would want to employ that might get us a better figure of savings across Government?

Amyas Morse: Perhaps Andrew would like to add something to this. To be frank, although we have had this impact figure for a long time—and I believe it will go up and down, and it has only gone up in recent years, but please do not assume it will always go up in the future; it could well go down, depending on where we are in the cycle—I really count our impact in changed behaviour by the departments concerned. We are looking at ways of evaluating that more clearly, trying to understand: are the lessons that we bring in and the recommendations the Committee makes truly being actioned? Are they being taken on board, not just politely complied with, but really driving a change in the way of working? That is what success really is, as far as we are concerned, and we are looking at increasing ways of doing that.

The Committee has helped us in that by insisting on following up on recommendations, and we really welcome that, but we are also looking for more sophisticated measures ourselves. To be honest, that is what I really would like. Real success is you point an issue out and you drive at it, and the department takes it into account and implements it.

Q51 Margaret Hodge: That is a difficult matrix to develop, but are you thinking in terms of reporting to the Committee annually on some sort of matrix that would allow us to look at, in a sense, the whole Government accounts? It is a change.

Amyas Morse: Yes, we are. We would like to move in that direction. We are looking at it and we are trying to move in that direction.

Q52 Margaret Hodge: What sort of timeframe are you looking at for that?

Amyas Morse: We will report annually. I think less than that will not make sense, but we have something in preparation and, I think, by the time we are at the end of this parliamentary year, we will have proposals for you to see.

Sir Andrew Likierman: Could I just add one thing?

Chair: Yes, please answer.

Sir Andrew Likierman: On the performance side—and this is something that, as a professional, I have spent my life looking at, so, of course, I have great interest in it—first of all, on the question of the figures themselves, before I joined the NAO I must say I was slightly sceptical about this number. All I can say is that we have looked at this number very carefully, and I am satisfied that the methodology is robust.

Secondly, in terms of measuring the performance of the NAO, I think it is very important that it be measured on a range of measures. Of course, the difficulty is that, as soon as you get into the softer side, it is more up for question and more judgment and so on, but actually it is critical that the NAO makes a long-term impact, which is more difficult to pin down, but I believe it has to be a combination of the short term and the long term. Thirdly, just to let you know, every month, the Board looks in terms of performance at what is going on inside the organisation. We are very focused on performance.
Q53 Chair: I must admit I still do not understand how you can have a target that one always exceeds. Either your victims are less and less competent or you are more and more super-competent. It does not make sense to me.

Michael Whitehouse: I am not 100% convinced that we will achieve it this year.

Q54 John Pugh: Could I just ask very briefly about the “identifiable audited savings” expression? Does that actually mean that you can follow something in a report and you can see it ultimately coming out in the budget? Take the example of stroke: you could say a certain amount could be saved by revising processes for stroke. You have put down a figure; they have become identifiable audited savings when you can actually follow a line in the Department of Health budget, where you can say, “That is how much they saved on stroke and that is thanks to us.”

Michael Whitehouse: The answer is: can you follow it through to the budget line? No, you cannot. I wish we could on that level. We do a lot of robust work to be as competent as we can be, but processes have changed and there is an indication that services are being delivered more cost-effectively. We try to get some independent assurance that is the case in terms of doing our job properly, and the work is audited by our external auditors, but it is not a perfect science. I know the PAC Chair made that opening comment, but it is a good indicator and it does focus on coming up with recommendations for how we can add real value, and agreed by the department.

Q55 John Pugh: Do the departments say, “Thanks for that”? Michael Whitehouse: No, not at all. It is not the department. If you are a Permanent Secretary, you do not want to be saying necessarily, “The auditors have found something that we could do better.” That is not the way that a psychological bargain or contract works.

The final point I would put on the record is that I have a long corporate memory, and Mr Leigh will remember that the Commission did ask our external auditors, I think, about 10 years ago to do an international exercise to look at how the NAO compared with other audit institutions. You would expect me to say—and it is on the record—that our approach came out as good as it probably could be; not that it could not improve but, in comparison with other audit offices around the world, we had got this to quite a robust level, and it has matured over a number of years. As Sir Andrew and Amyas said, it is by no means the only indicator. One of the good things that the Board has brought to this is it has said, “Do not just focus exclusively on this,” which we used to, “We need a much wider range of indicators to assess.”

Chair: Thank you for that, Mr Whitehouse. I think Mrs McGuire would like to ask you about your local audit work and the consequences of the abolition of the Audit Commission.

Q56 Mrs McGuire: I was probably going to ask you to do a quick SWOT analysis here. The opportunity is that the Audit Commission is being abolished; the threats, I would suggest to you, perhaps, are that you may not currently have the required skill base and, secondly, the speed with which the implementation is potentially going to take place. Discuss.

Amyas Morse: Let me kick off. The answer as far as “do we have the capability?” is concerned is we now do have Ms McMullan, who had just been Finance Director of Kent County Council. With her, we have 50-odd other staff who have previous local government experience, so we have good capacity to address this, and as much as we could reasonably have at this point in time. I just want to make that clear. As we move forward, it is important to realise that the rate at which all of this is going to happen is not quite clear yet. When is
the Government going to publish its response? When is the legislation going to be introduced?

What is clear to us at the moment is that there is a gap being left by the Audit Commission as it pulls back its activities, so we are starting to do what are broadly called national studies. We have already set some of those in train. We have started much stronger liaison with local authorities. We have started that and we have started work on what we do about providing guidance on the Audit Code.

On the national studies, we know we are going to be doing that, and we believed we could do it, actually, under our existing powers, so the reason we have not done it is because of the existence of the Audit Commission. Now the Audit Commission is not occupying that space, we will be doing a number of studies in that, looking at the interaction between local and national government and across local government, and that will probably be five, six or seven a year—some of these studies we would have done anyway but with greater coverage. We are moving forward and the resources we have asked for here are enough to get us moving forward, so that we are not flat on our heels in the event that things happen early, and we can occupy the spaces that need to be filled.

As to having the expertise, I really think we have made sensible moves. We have also brought in Mr Moon, who is now a director with us, who has previously been with one of the local health authorities, so again we have someone with hands-on experience. Although we have the technical skills to do this work, it is knowing what the experience is on the ground, which we are trying to supplement by bringing in people who have that capability. I think what we are doing is a sensible, balanced approach, moving forward but not going full tilt and then finding that things do not move as fast as we might expect.

**Q57 Mr Bacon:** Can I follow that up? The £2.3 million you are asking for includes, at least initially in this next year, two value-for-money studies, and the rest of it is for the development of your approach to the Code of Audit Practice. What does that actually involve in terms of pounds, shillings and pence? It is a lot of extra money, but it is not specifically targeted on value-for-money studies. There is an existing Code of Audit Practice that the Audit Commission has had. Presumably, based on what you have said previously, £450,000 or so of the £2.3 million would go on those two value-for-money studies. What does the £1.8 million or so—the rest of it—go on?

**Michael Whitehouse:** What we are seeking to do is to establish a shadow team that will enable us to set the Code. The other thing I would say is that what one learnt in the Audit Commission’s approach, which I think was the right approach, is that, in setting the Code, you have had to consult quite extensively with local government. The thing that we have been very at risk of doing—Mrs McGuire refers to it—and one of the important things, I think, moving forward is that the sector does not feel that this is the centre, including the NAO, doing this to them. Hands up: we recognise that we need to know a lot more about how local government operates. We need to consult with everybody and replace those networks with SOLACE, CIPFA and the Local Government Association, building up a core expertise within the NAO, so that our intelligence is well tuned and well developed.

This is a strategy and as, Amyas said, it is work in progress. At this point in time, it is our first cut at what we feel we must do. We will be very focused on, “Is this the most efficient approach?” We will come back to you again with our estimate in February, and this figure will be further refined. Based on quite good intelligence work, looking at what the Audit Commission is already doing, building up those networks, that is as good an estimate as I can get it.

**Q58 Mr Bacon:** Is this mostly extra people in your shadow team?
Michael Whitehouse: It will have to be. It will be a mix. I think the way it will operate is we will have some in-house staff with local government experience. Lynda, who has come in, has made a very good point that we need to have a rotation policy of secondments. We want to rely on data and we are doing quite a lot of mapping and analysis of data held by CIPFA, the Local Government Association, and the Association of Local Authority Treasurers. We are looking at the Welsh model and we are looking at the Scottish model, with close links with those audit offices, drawing out that intelligence, and we need to establish networks. It is a tripartite approach: people, information and networks, so that we are well advanced in understanding.

We want to be able to be in a position to pre-empt. If you are going to do national studies, you are going to have to look at things like financial resilience. It is no good coming in after the event, when it has all happened; you need to be doing the studies that are going to highlight the risks to the sector and to Parliament as well.

Q59 Margaret Hodge: One of the things the Audit Commission had was that it, itself, carried out the audit of—I do not know what proportion of local authorities—a proportion, which gave them an intelligence base, didn’t it? You are not going to have that.

Michael Whitehouse: The problem is the model has changed. We have not legislated for that model. Government is going to do it. They want a competitive market. The way you manage the risk in that model is the extent to which you have very good dialogue with the firms.

Q60 Margaret Hodge: Those firms’ clients are not you; their clients are the local authorities.

Michael Whitehouse: The leverage that you have over them is the setting of the Code. I was fortunate, 15 years ago, to work in New Zealand, where this model was applied, and you can get leverage but you have to work at it. You have to make it absolutely clear to the firms that they may be doing the audit on behalf of the local authority, where the link is, but there is a wider role that Amyas has as Comptroller and Auditor General in setting the requirement over and above true and fair, value for money, and regularity, which they have to comply with. There is a risk exposure to the firms if they do not get that right. I do not know if Amyas will want to say more on that.

Amyas Morse: Only just to say that, yes, it is a different model, and yes, you are right that you do not have the same flow of information as you do if you are doing work on the ground. Therefore, in order to get round that, you have to have very strong links not just to the firm but to the local authorities, and you have to make sure that you are talking to local-authority finance officers and you are getting feedback from them as to what they regard as important and relevant, and whether the standards of delivery are there or not. I think that is very important.

Some months ago, I went to a regional meeting of East Anglian finance officers and, actually, they were good enough to spend three quarters of an hour talking to me about what they are looking for from audit. They want to tell us—it is not going to be incredibly difficult to get their views, but we have to make the effort, get out there and do it, and we will do. You are right that there is an issue but there is a way to deal with that issue. The issue, in a way, is to get out of our office and get over and ask them how this is to be done.

Q61 Mrs McGuire: You are already working with the various institutes, then, to look at codes of auditing standards for local authorities.

Amyas Morse: Yes.
Q62 Mrs McGuire: In the same way, obviously, as auditors have codes of standards for a whole range of other organisations that they are involved in.

Michael Whitehouse: Yes.

Q63 Chair: When you take over this Code of Audit Practice, you can match the costs of the Audit Commission, can you, if you take it over?

Amyas Morse: We do not know exactly what the cost is, but we think it will be broadly the same.

Q64 Margaret Hodge: Increasingly, Chairs of other Select Committees come up and say, “Do you mind if the NAO does this bit of work for us or that bit of work?” I haven’t a clue how you decide who are you going to support and how, and the impact that has on us and you.

Amyas Morse: First of all, we start by thinking that our main relationship is with you, quite frankly, and therefore, if we are being asked to do something that we think would be considered to be PAC business—and you know I have done this before, Chair—I raise with you that I am being asked to do something by another Committee and ask, “Do you have a problem about it?” First of all, it is quite practical and we look at that. Secondly, we look at whether what we are being asked to do is something that is within our skill base and, preferably, something that is relevant to the areas that we are particularly interested in. If it is something where accounting skills will help, and particularly if it is something which has some bearing on evaluation and so forth, then it is a sensible request to make and we are happy to comply with it, within our budget capability.

Q65 Margaret Hodge: Is it a lot? I haven’t a clue how much you do.

Michael Whitehouse: The budget assumption is around about £2.2 million a year.

Q66 Margaret Hodge: Assisting other Committees.

Michael Whitehouse: Other Committees. If it gives you an assurance, the amount of money that we budget for support for the PAC—that is not delivery of the VFM reports or anything—is above that, at around about £2.7 million. I cannot remember exactly.

Q67 John Pugh: Could I ask you just briefly about missionary work? I was out in Montenegro at the weekend looking at financial scrutiny of that government, and there was a very intelligent and able young man from the NAO, who was certainly offering them more useful advice than I ever could. Is that going to be cut back under financial restraints, or is that funded in some other way?

Sir Andrew Likierman: One of the things that we did as we were setting up the new Board and when Amyas arrived is decide that we would cut back more generally on a lot of the overseas work, because we did not see it as being directly relevant and important to our central role. An amount of work outside the UK, for example for the UN, is done, but otherwise there is a restriction, related to the question of where the interest of the UK itself is involved. There is obviously a huge amount of potential work, which is possible, but that, we feel, would divert resources from the essential central work we are doing here.

Q68 Chair: We have been round this course before, haven’t we?

Amyas Morse: Yes.

Q69 Chair: Could I ask you about the clear line of sight? Is this going to have an impact on your organisation and make things more difficult for you?
Amyas Morse: It is certainly having an impact on all of Government in terms of who we are going to have to prepare consolidated accounts for, and that is all of the large departments. They had quite a tough time implementing International Accounting Standards last year, and we did a lot to assist them. This year, I concluded that they were going to find considerable difficulties, so we instituted a new approach, which the Treasury were very supportive of. I now have meetings with 17 departments. It is going to be annual review meetings, but this is the first one. We had this meeting to talk about the challenges they are going to face on getting their accounts done before the close: whether they could realistically do it, what arrangements they need to make, what resources they had, and whether they were suffering from optimism bias and so forth.

In most cases, I have agreed that we will have a further touch-point—of course, the teams are working together—between me and the accounting officer in January, and another one after the nine-month accounting point, around March, to see whether we are capable of getting this thing done or not. I have encouraged departments to think about this very carefully, because it is one thing saying now, “I do not think we are going to make it,” and another thing going crashing into the wall at the last minute because you really did not have the procedures in place.

We are working with the departments to try to help them to speed up, if possible to get it done before the close, but in some cases we are just trying to have an honest discussion to say, “Are you sure you can really get this done? We are not sure how this can be done.” It has been valuable, not only helping them with this process, but also, frankly, ushering in a new relationship where we talk to them very directly about these issues.

Q70 Chair: Thank you very much, Mr Morse, Sir Andrew and Mr Whitehouse. We have to ask a question of our external auditors: are there any matters that you consider it necessary to draw to our attention?

External Auditor: No.

Q71 Chair: That is very easy. Are you satisfied with this strategy?
Margaret Hodge: Yes.
Chair: We are satisfied.
Margaret Hodge: Good. Thank you very much.
Chair: Thank you for coming.