The future of public audit

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Contents

4 Foreword
by Huw Vaughan Thomas, Robert Black and Amyas Morse

5 Introduction, Over the shoulder … and through the mist
by Clive Grace

11 A new audit landscape
by Eugene Sullivan

13 Evolving public audit
by Steve Freer

16 Local audit – can we learn from the past
by George Jones and John Stewart

20 You don’t know what you’ve got ’til it’s gone
by John Haward

24 Tolerating public service failure
by Steve Bundred

27 We have to change to stay the same
by Rudi Turksema

30 Public audit and the challenge of sovereign debt
by David M Walker

33 Scrutiny and Improvement – the evolving role of public audit
by Amyas Morse

36 Public audit, public trust and good government
by Robert Black

40 Part of the whole – public audit and the Welsh public service
by Huw Vaughan Thomas

43 Public audit in the hard times
by Jan-Eric Furubo

45 Public audit – how transparent can it be?
by Nigel Johnson

47 Three tests of self-improvement
by Steve Martin

49 Public audit – a client’s view
by Michael Bichard

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Foreword

Public audit plays a key role in holding government and public services to account. In the past three decades, the functions of public audit have continued to develop, bringing an emphasis on performance and improvement as well as legality and propriety.

Since the late 1990s we have seen the creation of the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly. The governance and government of the UK has undergone a sea change. At every stage of devolution, the central role of independent, robust public audit has been recognised in the founding legislation and, in each jurisdiction, the post of auditor-general has been created.

The early years of this century have seen divergence in the public policies of the devolved administrations. This has been reflected in the diversity and innovation in public audit. In England, the proposed abolition of the Audit Commission has significantly changed the landscape.

In addition to these long-term changes in governance, the financial demands now experienced by public sector bodies are intense. The pressure to achieve more value for public money is ever-present, and all UK governments are keen to identify where efficiencies can be found and costs saved.

As a result, we feel it is right that, at this time, we should consider the future role of public audit and the contribution it can make to better government, better accountability, better public services and better use of public money.

We are pleased to support this SOLACE pamphlet which brings together perspectives from academic experts and practitioners. We thank Dr Clive Grace for editing the pamphlet, Philippa Mellish for her support work, and all the contributors.

The overall result is a stimulating and thought-provoking collection of views, including challenges to us in the responsibilities we discharge.

We hope that you too will enjoy and be challenged by the views expressed here.

Amyas CE Morse, comptroller and auditor-general of the UK

Robert Black, auditor-general, Scotland

Huw Vaughan Thomas, auditor-general, Wales
Public audit in these islands has a history that stretches over more than half a millennium. But like so many features of human society, it seems that much of its development has been crammed geometrically into the later stages of that historical period – initially in the last century or so, then concentrated more into the past 30 years, and more so again in the last dozen.

If this accelerated development is sustained, soon it may be hard even to keep up. But we need to try, and even to go beyond ‘keeping up’ in order to influence the future course of public audit. Because what it does, and whether it does it well, matters greatly to us all.

The milestones of the evolution of public audit are easy enough to point up. They reflect its visceral relationship to government, and to public services. Hence the growth of the state in the 19th and 20th centuries, and of the welfare state post-war, constitute major milestones simply in terms of the scope and scale of activity to which public audit has been applied. Nonetheless, the public audit function did not perhaps change very much in the UK prior to the invention of the Audit Commission as an instrument of government in the 1980s and as part of a concerted effort to transform (local) public services, and to shake them out of complacency and inefficiency.

The late 1990s and early noughties then witnessed the emergence of two major themes. One of these was the creation of separate audit institutional arrangements for the newly devolved nations of Scotland and Wales (Northern Ireland already had its own Audit Office). This represented innovation not only in relation to those new devolved governments, but also in the way in which responsibilities for public audit both for ‘central’ (i.e. devolved in this context) and for local government was brigaded and conducted.

The second theme was a significant expansion and extension of the responsibilities of the bodies responsible for local public audit in England, Scotland and Wales to encompass a range of inspectorial responsibilities, and a much stronger focus on matters of performance and improvement. This was the era of ‘Best Value’ and of Comprehensive Performance Assessment. It may be this was not a change in the function of public audit per se, but it certainly changed the character and scale of its intervention in public services. Most notably, in the Audit Commission, the functions relating to ‘Best Value’ and to inspection were in due course formally integrated into a combined division responsible for both performance audit and inspection. This was driven principally by the staff groups concerned –
they could not understand why these two things should be kept separate, given the extent of the overlaps they experienced in practice.

Now the Audit Commission is going, the NAO's role is augmenting, and the audit bodies of Scotland and Wales find themselves evolving further as Welsh (especially) and Scottish (with perhaps much more to come) devolution themselves evolve. And all this is against a backdrop of public services austerity, and the emergence of relatively recent understandings about some of the profound underlying problems of modern public services. These include the importance of policy-to-delivery chains running across multiple levels of government and public administration, the place of partnership and of 'joining-up' services and institutions, the critical role of the voluntary and third sectors (and of the Big Society), and the pernicious and deep-seated 'wicked' issues which have proved so resilient in the face of successive waves of policy initiatives and so very resistant to cure.

It must therefore be time to take stock, to think about the future of public audit and how its role can be optimised. It is the job of this pamphlet to contribute to that in a small way, and we have gathered a sparkling array of authoritative commentators to help.

Public audit under localism...

In the UK, and especially in England, the future of public audit has to be considered first in the context of the doctrine of localism being pursued by the coalition government, and the associated demise of the Audit Commission.

Eugene Sullivan, the current chief executive of the Commission, demonstrates in his dignified contribution that that process will be approached with the best interests of public service in mind. Steve Freer underlines the range of functions that the Commission has delivered, from financial audit through VFM work and into external performance assessment. He expresses trepidation, but against an underlying optimism that public audit overall will flex successfully to this and other drivers of change.

Through their illuminating historical review, George Jones and John Stewart also highlight the capacity of public audit to change, and they draw lessons to inform the future. They even flirt with the notion of a return to 'elective' rather than professional auditors (most widespread in the 19th century but which survived in some places until the 1972 Local Government Act). They endorse the approach for local authorities to choose their own auditors, and propose that while there should still be collective studies these ought to be under the joint control of local authorities through their own representative bodies. Their major fear is for too great a role for the Public Accounts Committee. As true localists of long standing, they detect a potential constitutional outrage if central government demands too much direct accountability for the grant it gives to local government.

But from a perspective informed by experience of local government in Kosovo as well as the UK, John Haward sounds a warning note: Don't throw the (improved local government) baby out with the (excessively muscular regulation) bath water. Government must strike a balance, and should be careful not to over-react first one way, in reducing external assessment, only perhaps in due course to swing back too far, if services decline in the face of reduced scrutiny.

The very direct question that arises from more localist arrangements is the extent to which government may be willing to allow local public services actually to fail, which is of course what can happen to private sector entities and what can also happen to public sector bodies in some other countries. Steve Bundred, the former Audit Commission chief executive, asks this with reference to the experience in the US. It is a fair challenge, and one with uncomfortable implications. Partly because of the deployment of external performance assessment by many public audit bodies in recent years, we have got used to almost the exact opposite. Public service entities were given periodic 'health checks' and then experienced intervention for ongoing poor performance, let alone impending total failure. It
seems likely that even in an era in which local authorities are expected to take more responsibility for their own actions, the consequences of failure both for citizens and for ministerial reputations would be such that it would (in some way) not be allowed. The huge vertical fiscal imbalance between local and central government, with central government largely paying for local services, would ultimately likely create a powerful sense of ministerial responsibility and an unwillingness to stand aside in the face of likely failure. If that is right, we have found one of localism’s limits.

...and public audit under globalism

Meanwhile, of course, the austerity measures under which UK public services labour reflect the impact of the global financial crisis. Two of our contributors in particular make us lift our eyes to those wider forces, and think about how public audit should or could respond at what might be thought of as the global and trans-national strategic level rather than the national and local operational level. Rudi Turksema, of the Netherlands Court of Audit, highlights the importance of public audit in helping to identify more opportunities for efficiency and for the best use of public money during times of austerity. But he also draws attention to the role of public audit in ensuring that the big picture is not lost sight of – and in particular the huge sums of public money being injected into the economies of several countries in an effort to moderate the consequences of the crisis.

Turksema also recognises the continuing need to re-assess the place and impact of public audit in what he calls the ‘networked society’, in which a tweet can have more impact than a worthy report.

David M Walker, former US Comptroller-General, brings his experience and authority to bear in addressing the serious financial, fiscal and operational challenges faced by many major governments. He stresses the importance of transparency and accountability in helping to facilitate broader public understanding and accelerate the reforms which are needed. The Sovereign Fiscal Responsibility Index, for example, provides one comparative instrument which can shed light where it is needed at the global and trans-national level. This should be linked in his view to the further modernisation of current governmental accounting/reporting and auditing standards and practices.

The triumph of tradition?

In a former life I was myself the director-general of the Audit Commission in Wales and also at the same time the deputy-auditor general for Wales, with the job of leading the creation of the Wales Audit Office from the ‘Welsh’ parts of both the NAO and the Commission. In doing that I also took a good look at the Scottish arrangements, and how they achieved the balance of responsibilities between the Auditor-General, Audit Scotland, and the Accounts Commission. I have seen at close quarters how in practice ‘national’ public audit bodies can manage the inevitable central/local tensions when they carry responsibilities for local as well as national public audit. So I have relatively few concerns about greater NAO involvement in local public services. Indeed, I think it could have some advantages, especially in the audit and performance review of the policy-to-delivery chains which are so critical to successful and efficient public services, but also in more thoroughly ‘joined-up’ assessments.

What always did surprise me a little was that such an important part of the modern 20th century governance development entailed in the UK devolution process should turn out to be an institution – the role of Auditor-General – which had its roots in the 14th century. In some respects the governance of a body like the Audit Commission, with a broadly independent non-executive board established according to statute, looked to me to be more ‘modern’. Yet there was another crucial difference of course, in that the UK Auditor-General reported to the UK Parliament, and the Audit Commission to government. The Scottish Parliament and the Welsh Assembly made their choices felt, and acquired parallel institutions to the UK Comptroller and Auditor-General in their
Introduction

respective Auditors-General for Scotland and for Wales. They made special provisions to ensure the independence of local government, but overall resolved the issue of the accountability of public audit itself firmly in the direction of the legislature rather than the executive arm of government. But if this was a triumph of tradition it is not one of unchanging tradition or resistance to change. As important as the history may be, Amyas Morse admits to being more interested in the future of public audit than its past. He articulates strongly the modern idiom of public audit of being concerned to support improvement as well as to hold to account. While he will not audit local authorities or appoint their auditors, nor does he see himself as being at arms length. Many in local government have valued the effort he has already made to meet them and to understand the sector better, and respect his intention to support the drive for further improvement across public services as a whole.

Bob Black, the Auditor-General for Scotland, finds the roots of his own modern mission even further back in time than the 14th century. He draws on the lessons of civilisations that ultimately stagnated or which failed to deliver on the importance of accountability and trust to underpin effective government in the long term. He shows how public trust cannot be taken for granted, and must be continually worked for and renewed, partly by politicians and by public services professionals, but also by the efforts of public audit. He cites the principles of public audit as fundamental to that work:

- Public sector auditors should be independent from the organisations being audited
- Public sector auditors should operate with a wide scope. In addition to the audit of financial statements, public audit should be concerned with regularity (or legality) and with propriety (or probity standards)
- Public sector auditors should also conduct performance audits to provide independent analysis and findings on whether public bodies are providing value-for-money
- Public sector auditors should be required to make the results of their work available without restriction to the public and to elected representatives

These principles are also at the heart of the work of the Wales Audit Office, and its Auditor-General Huw Thomas, and they clearly help to forge a powerfully complementary approach across the United Kingdom, supported also of course by common accounting and auditing standards. Yet Thomas also stresses the divergence taking place in Wales as it exercises the relative freedoms of devolution to explore new and innovative models for public service provision, and the need for public audit to respond to that. He also highlights the critical dimension of timing – the classic audit response is ex post facto but sometimes it may be better to offer review and challenge at an earlier stage, even if the scope of an earlier intervention has necessarily to be more limited. The element in the tradition of public audit which is perhaps of greatest value of all, and which all three Auditors-General hold dear, is that of independence.

Jan-Eric Furubo, auditor-director of the Swedish National Audit Office, helps us to understand very clearly that this is something which is fundamental for the future as well as the past, and that it is just as important – indeed, even more important – in the era of constant change in which we now live as in times of more relative stability.

What should be done?

There are many potential ways in which public audit might develop in the face of current challenges. One of these is set out by Nigel Johnson, and might be thought of as ‘sweating the audit asset’. This would mean better reporting for both private and public audit, and the ability of shareholders and citizens alike to benefit more from the privileged insights which auditors gain of their clients’ businesses and services. This has to be tempered by considerations of liability, risk, and cost, but Johnson clearly considers that some greater impact and benefit from audit reporting ought to be possible.

For Steve Martin, focussed strongly as he is on
the question of improvement and the elements which will (or only may) contribute to that, the issue resolves itself into the part that public audit could play in helping address the key aspects of service cost, organisational capacity, and credibility. He recognises, and broadly celebrates, the modern fashion of self-improvement, but clearly has doubts as to whether it is likely to succeed fully if left entirely to its own devices.

Finally, but hardly least, Michael Bichard speaks up as a major former consumer of public audit outputs via his roles as local authority chief executive and permanent secretary, and one who was always hungry for change and wanted public audit to be a stronger ally in that quest. He gives public audit credit for highlighting failure, and in supporting citizen interests against unbridled professional power, but his wider disappointment is palpable. There has in his view been a missed opportunity. Public audit could have been far more incisive in helping to identify the causes of problems as well as reporting their consequences, in following up their own work more assiduously, and even in questioning or criticising policy (or the policy making process) itself. It is perhaps unlikely that others would as readily risk the inevitable constitutional question that would follow from this last step, though he suggests that it ought to be possible without trespassing on the prerogatives of ministers to make policy and political choices.

A strategic debate?
Although he does not ask for it as such, Bichard’s observations highlight above all the profound emptiness where we ought to be able to find a strategic conversation about the future role of public audit. Like or loathe Philip Hampton’s 2005 review for the then chancellor which ushered in, inter alia, a more muscular brigading of public services audit and inspection, it represented a considered strategic view of the matter. Persuaded or not by the principles of inspection articulated by Sir Ian Byatt and Sir Michael Lyons (including the startling proposition that part of its role is to support leaders in effecting change) at least they offered an approach which was comprehensive and focussed. Attracted or repelled by the Audit Commission’s statement of the 10 principles of public services regulation, one could at a minimum have an argument about whether they were the right ones, or whether there should be any at all.

We do of course have the principles of public audit, and they are a valuable rudder and an occasional sea anchor too. But they are not enough. They will not serve sufficiently to answer the questions posed by the challenges of localism and of the global financial crisis. They will not of themselves ensure that public audit transcends the organisational boundaries which bedevil so much public services effort, especially in respect of the wicked issues. Nor will they ensure that public audit gets joined up across the devolution divide, where appropriate, to help inform citizens and policy makers about the rich variety and the comparative shortcomings that need to be studied and named and discussed. At the minute we are more likely to get such material from the OECD than from any domestic source, and that should not be.

The abolition of the Audit Commission, whether right or wrong, was a matter on which the government was entitled to take a view. But it does not amount to a strategic approach to making the best use of current public audit resource in the face of profound challenges, and nor does it create the basis for the kind of debate which is needed about what public audit could be and could do beyond (or instead of) what it does now.

If this pamphlet helps to stimulate and support the kind of conversation which is needed, it will have served public audit as best it could ever have done.

Dr Clive Grace is chair of the SOLACE Foundation Imprint and chairs the Research Councils’ Shared Services Centre Ltd, the Board of BT Wales, and World Heritage UK CIC. He is also senior Independent director at Nominet, and an Honorary Research Fellow at Cardiff Business School.
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A new audit landscape

Despite its uncertain future, the Audit Commission still has a vital statutory role to play, as well as overseeing the new audit regime, says Eugene Sullivan

A system in transition
It is now over 18 months since the government announced its intention to disband the Audit Commission and legislate to create new arrangements for local public audit in England. The new arrangements will reflect four design principles: localism and decentralisation, transparency, lower audit fees and high standards of auditing.

Giving local public bodies a new duty to appoint their own auditors is an example of the government’s localism policy in practice. In addition, the government believes savings could be made by local bodies procuring their own auditors and by transferring audit regulation to the profession.

The first step involved outsourcing the Commission’s in-house audit practice. The Commission has awarded contracts to four firms for five years. This will be the first time in the Commission’s 28-year history that all the work to audit the accounts of public bodies in England will be carried out by private firms. This is a huge transformation of the largest public audit market in the UK. It has diversified the market as, although two of the successful firms are existing suppliers to the Commission, Grant Thornton and KPMG, two will be new to the market: DA Partnership (a wholly owned subsidiary of Mazars) and Ernst & Young.

The procurement exercise has demonstrated the Audit Commission’s unique purchasing power by delivering savings to public bodies of over £30m a year for the length of the contracts. These savings will be passed back to audited bodies. A very much smaller Commission will remain to exercise statutory functions. The Commission will consult on the new auditor appointments that come into effect from 1 September 2012 and most audit staff will transfer to the successful firms at the end of October.

The procurement and appointment of auditors has been carried out under existing legislation. New legislation is necessary to complete the reforms. So, what are the next steps?

The implementation of a new audit landscape
Between March and June 2011, the Department for communities and local government (DCLG) consulted on its proposals for the future of public audit. The Commons communities and local government select committee published a report, also in June, suggesting that:
• auditor independence must be strictly maintained
• local audit committees must have a majority of independent members

additional safeguards are needed to ensure the
**A new audit landscape**

continued effectiveness of public interest reporting and

- the scope of local government audit should be proportionate and risk-based.

It should allow for local innovation and application, particularly with regards to local value for money work.

DCLG’s response to the consultation set out revised proposals. The department has also run events to engage stakeholders on key issues. This will inform a draft bill, expected to be published for pre-legislative scrutiny in late spring. The timetable for laying the bill, and beyond, has not yet been determined.

**Unresolved issues**

There are significant issues still to resolve before new arrangements can be implemented. It is not clear how the new Independent Audit Appointment Panels (IAAPs) will work. They are intended to advise local public bodies on appointments, but certain questions remain. What happens if a body chooses not to accept the recommended appointment? What is the role of a shared IAAP in relation to a public interest report to one of its constituent bodies? How will it exercise any such role in practice? Will it have the influence and resources to act as an effective bulwark for auditors’ independence? There is still much to do to demonstrate that IAAPs are an acceptable substitute for proper independent appointment.

The future arrangements must continue to provide assurance to Parliament about the money it votes to government departments, but which local bodies spend. Departmental accounting officers will still need to rely on the audit process for assurance that the funds distributed to local public bodies have been safeguarded and accounted for properly.

The Commission’s coordination and quality assurance of appointed auditors’ work, and the range of annual reports summarising the results of auditors’ work at local public bodies, provide accounting officers with essential assurance on how billions of pounds of public money is spent. How, and from whom, will accounting officers get this assurance in future?

And what if government needs to respond to a major failure by a local body, as it has had to in the recent past? Localism can, and should, be relied upon to protect the interests of local communities, but localism alone may not be enough.

The proposed regulatory framework provides for three separate agencies – the National Audit Office; the Recognised Supervisory Bodies; and the Financial Reporting Council – to perform the Commission’s current regulatory role. These bodies are eminently well-qualified to perform these tasks, but there is a risk that the whole will be less than the sum of its parts. The Commission, unsurprisingly, believes a single, integrated regulatory body is more efficient and effective.

Finally, the proposals will bring new costs for audit firms and for local public bodies themselves, which inevitably will be priced into audit fees. There will be new compliance costs, to fund the new regulatory framework, and firms will incur extra costs of preparing and making multiple bids.

So what gives the Commission its purchasing power? The Commission is able to separate the contract award decisions from the appointment of auditors, enabling it to offer large volume contract lots, without first having to reconcile the appointment needs of over 1,000 major local public bodies. This ability will not be replicated – even local purchasing consortia will not be able to separate contracting from appointments in this way.

There is also a risk that some bodies may be considered unattractive on commercial grounds, because they are too risky or are geographically remote. Such bodies are also likely to face price premiums, or the possibility that there will be no auditor willing to bid for their work. The Audit Commission, however, will be around for the foreseeable future, overseeing the audit regime and managing the contracts with the firms and will continue to support DCLG, the NAO and other stakeholders to develop and implement new arrangements that are effective, proportionate and sustainable.

_Eugene Sullivan is chief executive of the Audit Commission_
Evolving public audit

The abolition of the Audit Commission is not the only driver for change, argues Steve Freer. Transparency, austerity and localism are also in the mix.

Shock and Audit
The proposed abolition of the Audit Commission remains one of the most unexpected policy announcements made by the government. While the subsequent storm of controversy has long since blown over, there remain considerable uncertainties about its implications for the long term health and success of public audit in the UK.

The Commission has made a very significant contribution to our public services during its relatively short life. As well as discharging its core responsibilities for local financial and value for money audits, through a mixed market of high quality providers, it has also highlighted many of the key opportunities for efficiency and service improvement across the local public services landscape. Additionally, from the late 1990s it has led much of the thinking about systematic performance measurement and assessment in public bodies and, latterly, within a defined place.

Change drivers
The abolition of the Commission is an immediate driver for change in relation to public audit arrangements. However, it is not the only driver. Other government policy themes, such as transparency, austerity and localism, add interesting flavours to the mix. Additionally we may see some pressures for change arising from European Commission and UK reviews of private sector auditing in the wake of the global financial crisis.

In shaping the future of public audit it will be important to draw on the experience of all of the public audit agencies over the recent past. Many of the lessons will be relevant to decision making about what is retained, modified or abandoned as public audit itself adapts to a new era and climate.

In contemplating how public audit might change it is useful to focus on three key components: financial audit, value for money (VFM) audit and performance assessment. This is not intended to be an exhaustive list. But these clearly are three important areas in which future arrangements must be fit-for-purpose in the public interest.

Financial audit
Financial audit is a cornerstone of good public accountability. It is critically important that high standards are maintained for all public bodies, including appropriate attention to the standards of stewardship, probity and transparency which are expected of public office holders managing public money. Public auditors must retain not only the power but also the courage to issue special
Evolving public audit

Public interest reports where these standards are found to be significantly lacking.

Experienced public auditors understand the distinctive characteristics and expectations which differentiate public audit from the audit of private sector entities. It is important that any new entrants to the market are also familiar with these nuances.

The independence of the auditor is also critically important. This is common ground with private sector audit. However, threats to independence are likely to manifest themselves in different ways. For example, a critical report or a qualified audit opinion is potentially a significant blot on the copybook of a politician seeking re-election. The government’s intention to shift to a model in which local authority auditors are appointed by the council remains an area of real risk for auditor independence.

Value for Money audit

The delivery of VFM is clearly very important in an era of austerity. The minimisation of waste and maximisation of value from every pound of taxpayers’ money are critical challenges for the management of every public body. Of course VFM audit is not the only resource at their disposal but it is a proven model and one on which the public, their elected representatives and the media place particular reliance.

The overriding challenge is to embed a culture of VFM in public bodies. For this reason one strand of the public auditor’s work should ideally involve giving an opinion on overall VFM performance and culture. This is a valuable service to audited bodies and their stakeholders, and a helpful platform from which to calibrate the scale of original VFM work which the auditor needs to carry out.

‘In practice individual bodies understand these risks and their potential significance to the reputation management of the sector’

Performance assessment

The measurement, assessment and management of performance are important inter-linking challenges for large complex organisations of any type. They are particularly significant challenges for public bodies where the absence of profit as an over-arching measure adds to complexity.

Those charged with governance and corporate management need intelligence about how the organisation as a whole and its constituent parts are performing. Without hard, reliable, timely information they are steering the organisation blind.

A number of regimes, including the Audit Commission’s Comprehensive Performance Assessment and Audit Scotland’s Best Value Audit have helped to establish these disciplines in organisations and provided independent judgements on the performance of audited bodies.

Public auditors are unlikely to have such extensive involvement in these areas in the future. Nevertheless as part of their VFM work they should retain a studied interest in the entity’s ability or otherwise to maintain an objective high level view and to manage performance effectively throughout the organisation.

How this is achieved will depend upon decisions taken by management. This is where localism may well be given its head – each organisation tailoring its own custom designed approach. Superficially this is a very attractive prospect. But we know from experience that it carries risks – of inability to compare performance reliably across the country and of underperformance or failure if an organisation fails to make effective arrangements.

In practice individual bodies understand these risks and their potential significance to the reputation management of the sector. As a result they may well take action or co-operate with sector-led initiatives to mitigate them.

Auditors will be well placed to scan these risk areas and organisations’ responses, and to highlight any concerns in their reports.

Conclusions

Public audit is likely to change over the next few years. The abolition of the Audit Commission is
a major driver for change but there are others - for example, austerity, localism and reviews of private sector auditing following the global financial crisis.

In developing new systems of public audit we must take care to learn lessons from the experiences of the past several decades. Public audit has not stood still; it has evolved to meet new expectations and requirements. I have every confidence that it will continue to do so successfully.

*Steve Freer is chief executive of the Chartered Institute of Public Finance and Accountancy (CIPFA)*
Local audit - can we learn from the past?

George Jones and John Stewart reflect on the past and recent experience of local public audit to identify guidelines that should shape future audit arrangements.

Elective audit and district audit

The Municipal Corporations Act 1835 prescribed auditors and auditing for the boroughs it was creating as the foundation for elected local government in urban areas. The Act provided for two elective auditors chosen each year by the local-government electorate and one appointed by the mayor from the council members. There was no provision for professional audit or auditors; auditing was to be carried out by laymen.

Professional auditing was introduced at the local level by the Poor Law Acts of 1834 and 1844, which provided for professional auditors to be appointed nationally to audit the accounts of local poor-law authorities. On this foundation district audit gained local government’s respect for its expertise and experience.

There was a clear distinction between lay auditors in the municipal boroughs and professional audit for the poor law, and increasingly for other authorities like the separately-elected school boards (1870), county councils (1888), district councils (1894) and metropolitan boroughs (1899). When education became a function of local authorities in 1902, district audit continued to audit the education accounts of the municipal boroughs while lay audit was retained as their main form of audit until 1933, although a number of these boroughs took powers under local acts to replace elective audit with district audit or other professionals. The 1933 Local Government Act gave councils the choice between elective audit, district audit and other professional audit.

Elective audit had been much criticised by professionals, by judges and by academics as inefficient and ineffective but had shown great resilience having remained the main form of local audit in most municipal boroughs for almost one hundred years. It was still used by 21 authorities when finally abolished by the Local Government Act 1972.

While the case for professional audit is now accepted as the basis of audit for financial practice, probity and legality, elective audit recognised there was more to audit than the application of professional standards. It suffered from uncertainty about its role and duties, and from low turnout since its elections were held separately. Elective auditors could have found a role as the voice of the public on the audit committees of local authorities, although that role can be played by elected councillors. The need for recognition of lay judgment in the role of audit is relevant when considering the establishment of the Audit Commission.
The Layfield Report and the Audit Commission

The Local Government Finance Act 1982 set up the Audit Commission. The Layfield committee (of which we were members) recommended a role beyond traditional professional audit. Its report, Local Government Finance, recommended:

- the audit service in England and Wales should be made completely independent of both the government and local authorities
- the head of audit should make regular reports on issues of general interest or public concern relating to more than one authority. These reports should be available to the public. They should be concerned particularly with comparisons between the methods employed by local authorities and the results achieved.

In describing other reviews that could be pursued by the Audit Commission in its wider role the Layfield committee said “special staff” might be required recognising the different experiences required beyond professional audit.

The Audit Commission was appointed with a strong role, independent not merely of local government but of central government. It impressed local government with its readiness to criticise central government. Its 1984 report on block grant was headlined by The Times as “Watchdog bites owner” for its devastating critique of government policy on local-government finance.

The Fateful decision

In the 1990s the Audit Commission took a fateful decision to undertake Best Value inspection on behalf of the government. This decision turned the Audit Commission in effect into an agent of central government. In his authorised history of the organisation, Follow the Money, Duncan Campbell-Smith described the long discussions among both Commission members and staff. He quotes Helena Shovelton, the future chair, as telling Commission members “Look folks, if we don’t do Best Value [inspection], there won’t be an Audit Commission”, portraying a bleak future as its functions were given to other bodies.

The Commission’s decision to accept the role of Best Value inspection on behalf of central government marked the end of its independence, which was confirmed as further tasks required by central government were placed on the Commission: inspecting local authorities’ performance, judging and scoring them. These inspections became the basis on which central government judged local authorities, relying on the Commission's improbable assumption of inspectoral infallibility rather than on the judgment of councillors as the elected representatives of voters whose experience ranged far beyond the short time spent by inspectors in the locality. There were no more reports displaying the independence of the report on block grant. In the end the outcome was the government's proposal to abolish the Commission.

The danger of a Public Accounts Committee intervention in local government

The primary accountability of local authorities must be to their electorate who choose and can remove the councillors who constitute the council as the authority’s governing body. There is a danger of central government and the House of Commons insisting there must be accountability to them for the use of grant by local government.

This approach is shown by the 2011 report, Accountability: Adapting to decentralisation, by Sir Bob Kerslake, permanent secretary at the Department for communities and local government. Many in local government thought this report would be concerned with how accountability could be ensured for expenditure by the growing number of community groups, local appointed bodies and contractors in the government of local areas.

Their accountability was far from clear, whereas local authorities have clear accountability to their electorate and well-established procedures for ensuring probity. The Kerslake report took what at first sight seems a sensible and
Local audit - can we learn from the past?

realistic approach that central government and Parliament should ensure there were adequate processes for accountability rather than that all local bodies should be directly accountable to central government. The report proposed that central government departments should prepare accountability system statements setting out procedures to ensure the accountability of such bodies and of local authorities.

The arguments used to support the case for this approach show that what is proposed is far more intrusive than might be thought, opening the door for a wide-ranging concern by both central government and Parliament with how local authorities are run. The report sets out what permanent secretaries as accounting officers should be concerned about in reporting to Parliament through the Commons public accounts committee (PAC). “It is not sufficient for there to be a robust system in place to ensure regularity and propriety and to secure value for money. Accounting Officers must also be able [to] demonstrate to Parliament that it works in practice”. Accounting officers would then be reporting to Parliament, presumably through the PAC on the performance of local authorities, which will inevitably involve consideration of their way of working. This approach could lead to the PAC, presumably advised by the National Audit Office, extending its remit to cover the working of local authorities, claiming that accountability to Parliament is essential for the use of national resources given through grants to local government. The result would be to confuse the accountability of local authorities, undermining rather than sustaining their accountability to their local electorate.

Conclusions

The past experience of elective auditors as the main basis of auditing in municipal audit for nearly one hundred years raises the issue of what are the respective roles of professional judgment and lay judgment in the audit of local authorities. While professional audit has a proper role in certifying local authority financial accounts as a true record and in ensuring probity and legality, once auditing extends beyond those tasks to encompass value for money and performance, these issues should be for lay judgment rather than for professional auditors. That judgment is properly exercised by councillors on behalf of the electorate they represent.

Although the past experience of elective auditors reflected the importance of lay judgment, we would not propose their re-introduction. A return to elective auditors would challenge the representative role of councillors, causing confusion as to who represented the electorate. There is, however, a question of whether there should be lay representatives on the audit committees found in an increasing number of authorities but with outside appointments often restricted to professionals or representatives of outside interests. If lay representatives were sought, then how should that be achieved: by election, by ballot as in ancient Athens or by representatives of community groups? It may be an insoluble but also an unnecessary problem. The proper source of lay judgment lies with councillors as elected representatives whose role should be strengthened.

The government proposes that local authorities should choose their own auditors. We support this proposal as consistent with both localism and practice in many organisations. We would oppose any suggestion that the National Audit Office should be responsible for the audit of local authorities. This role would be a constitutional outrage and produce a professional monopoly to which the government is rightly opposed. If there are to be different types of auditors, then councils should be able to choose their own, including district audit. Over the years district audit has developed important experience in practice, which should be maintained as a mutual organisation rather than merged with private-sector firms or national bodies. This approach is all the more desirable because what is likely to emerge from decentralisation to markets will mean the big four or five with only limited commitment to the values of local government.

Special studies drawing on the experience of
local authorities should continue to be undertaken, but under the responsibility of local government through its collective bodies. Past experience has shown that the “independence” of the Audit Commission was not sustainable against central-government pressures. There are also dangers for local government in extending the role of the National Audit Office and the PAC into the accountability of local authorities, undermining their primary accountability to their local electorates, which collective local-government responsibility could sustain.

Past experience has lessons for the present and future, even where that past experience is too often forgotten.

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*John Stewart is Emeritus Professor of Local Government at the University of Birmingham*
It’s easy to see why regulation has fallen into disrepute. Its baroque over-ornamentation was increasingly costly, imposed yet more central control from an already top heavy state and sprouted countless indicators and targets.

Governments regularly tell us that the thousand-flowers-blooming diversity of markets frees initiative, innovation, learning, and efficiency; yet in its own backyard, the English government ran a system about as centralising as its gets. So let’s raise a glass to the demise of all that.

And yet, we should also be wary. Surely public life is enhanced by the free exchange of credible, verifiable data; by evidence based analysis of policy; by comparative data that helps us see that this bit of the public sector seems to be working well while that bit doesn’t; and a climate in which challenge to both policy and performance is legitimate, and – if conducted intelligently and with insight – welcomed and acted on. All this depends on a degree of public regulation, i.e. some system that tends to strengthen the integrity both of the system as a whole and the data that oils its wheels, and that has some element of dispassionate but informed and professional challenge.

The Kosovo contrast
It was not always like this, and in many places it still isn’t. Not everywhere shares the assumption that public service is about service to the public; and even if that is a shared assumption, an absence of evidence or data makes policy making or performance improvement largely anecdotal.

I am part of a small EU team advising the government and municipalities of Kosovo as they emerge from an horrific recent past. It is a very instructive experience.

For instance, I recently discussed service improvement with several elected mayors and senior managers in Kosovo. I was trying to show how simple data about performance could be used to help illuminate good practice. It was no masterpiece of public speaking, but had some carefully chosen, topical examples, straightforward but thought provoking, that would capture imaginations. Or so I thought.

In fact, there was not a single question or comment. One kind mayor told me later that it was necessary to explain why improvement in public services matters, and also that officials might actually have some responsibility for it. These were not universally shared assumptions.

The value of data
Even if the impulse to improvement had been a shared assumption, there is a dearth of
meaningful data at central or local level to inform policy and assess performance. Debate often proceeds with too little hard information to make rational policy; it’s either not collected, or held to belong privately to the agencies that do collect it. Financial data in local government is better, but it can be all but impossible for the citizens to find it. There is even less about comparative performance. There are formal independent audit reports; but it doesn’t matter if year after year the auditor finds that, for example, a particular municipality has no system for accounting for cash. In effect they might as well collect cash in a bucket, such are the lack of controls; but there are no consequences for this. At the macro level, the recommendations of a recent World Bank report on economic progress were based on faulty data. Fortunately that one was defused; but it was a close run thing.

In such an environment, corruption can flourish, and allegations of corruption cannot be readily combatted. This is not just in the cash sense (does all that money in the municipal bucket end up where it should?), but officials and politicians are essentially unaccountable. Debate on policy and performance is in effect largely anecdotal. Improvement is much discussed, but unsystematically. A series of seminars to exchange good practice among municipalities is currently based mainly on the self-reporting of individual managers telling each other what they think they do well; that’s OK as far as it goes, but it’s hardly rigorous. In this environment, phrases like citizen empowerment, probity, transparency, or evidence-based policy making seem very distant.

Of course this may be inevitable in an emergent state. Creating a pool of data that is meaningful and has integrity takes time, and a cost that can be hard to justify where investment is urgently needed for more tangible things. But for me the surprise is that many people in positions of influence and authority don’t think it’s a problem. To build a properly working system will take years of patient effort, starting by convincing sceptical hearts and minds that it can and should be different.

**But it’s quite different in England .. isn’t it?**

Returning home, I am not suggesting that rolling back public regulation leads straight to the dysfunctionality that Kosovo is struggling to escape. But I do believe that the generally positive nature of local government in England did not just happen, and cannot be taken for granted.

English local government is of course far from perfect; it is also home to people whose motives are less than public spirited, and to the lazy, venal and incompetent. But on the whole they don’t have the upper hand. This is partly a result of history, but also a complex system of pressures, checks and balances that needs to be kept in good order. Roll back the regulators too far, and something intangible but valuable seems to me at risk here that we may have to reinvent not far down the track.

It’s an irony that intellectual currents tend to flow strongly in different parts of the public domain, yet quite often in completely opposite directions. It’s hard to see the government giving, say, Northern Rock an option to reject Sir John Vickers’ recent recommendations, since those are drawn by independent observers based on the evidence, and not optional. Nor would I bet much on the Leveson enquiry recommending still lighter touch self regulation for the press. Each time there is a death in care, do politicians demand less rigour as the solution? In the meantime, thinking around local government heads in the opposite direction.

As a cri de coeur, please don’t throw out the baby with the bath water sounds rather mild mannered. But it is heartfelt. We can see all too clearly what happens when the state gets that balance wrong.

John Haward is former director for Local Government Office of the Deputy Prime Minister. *He has spent the last 25 years in strategy and management roles and as an independent consultant, alternating between local government, the civil service, and the voluntary sector*
You don’t know what you’ve got ‘til it’s gone

Ethnic Albanian men work at constructing a new mosque near an old one in downtown Pristina, Kosovo, as the country emerges from a horrific past. Photo: Murad Sezer/AP
There is a long association between the Public Leaders Network, the Guardian’s website for senior managers of all public services, and the Solace Foundation Imprint, and we are delighted to continue that association with a publication on the future of public audit.

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Jane Dudman, Editor PLN
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They do things differently in the United States. On 9 November 2011, Alabama’s Jefferson County, which has a population of 660,000 and is home to Birmingham, the state capital, declared itself bankrupt. With debts of $3.14bn it was the biggest municipal bankruptcy in US history. But not the first.

Harrisburg, the capital of Pennsylvania, filed for bankruptcy the previous month. The city of Vallejo in the San Francisco Bay area of California, with a population greater than that of a small English unitary, was discharged from bankruptcy within days of Jefferson County going bust. In May 2008, Vallejo had become the largest city in California ever to declare itself bankrupt after defaulting on loans of over $200m. But even this was small beer compared with the 1994 bankruptcy of California’s Orange County – the largest in US history until last year.

Jefferson County’s problems arose from a toxic mixture of incompetence and corruption, and did not happen overnight. They began in 1996 when a judge ordered the council to rebuild its sewer system after raw sewage was found to be polluting streams and rivers. To do so, the county borrowed money on the bond market and later converted these loans into a string of variable rate securities and complex derivatives. But bribery and fraud in the letting and management of contracts caused delays in project implementation and rapid escalation of costs. There was also bribery in the refinancing of the loans from fixed to variable rates, the cost of which then soared as a result of the credit crunch in 2008. So having originally estimated that the project would cost $250m the county soon amassed total indebtedness of more than $5bn. Some 22 people received criminal convictions for the events that led up to this. All but one went to prison, including the Mayor of Birmingham, who got 15 years.

The consequences for public service users in Jefferson County have been predictably horrendous. Staff have been sent on unpaid leave and hours have increased for those still in work. The local sheriff has announced that his deputies will no longer respond to traffic accidents. Prisoners are sleeping on the floor of one of the county’s two jails because the other has been mothballed. Local elections have been cancelled. But things could yet get worse. Vallejo only managed to exit three years of administration as a result of slashing public sector salaries and pensions and laying off half the fire department and a third of the police force. Fire stations were shut and prostitutes flooded in from as far as 500 miles away.

Tolerating public service failure

Greater localism is all well and good, says Steve Bundred, but what exactly is the governments’ and the publics’ appetite for the risk of total potential failure in a public service?
away, knowing there was little likelihood of being arrested.

When Orange County went bankrupt the principal cause was rash speculation by the county treasurer, who later pleaded guilty to six felonies in connection with it. Other than the criminality, there were, as in the case of Jefferson County, many similarities to the near collapse of Hammersmith and Fulham arising from its involvement in the interest rate swaps market in the late 1980s. But Hammersmith and Fulham was prevented from leaping over the cliff by the intervention of its auditor. So why are citizens in the US prepared to tolerate municipal failures that we would find simply unacceptable in the UK?

**Varieties of localism**
The answer of course is the genuine localism that characterises the US system. They don’t believe it’s any part of the function of higher tiers of public administration to prevent failure by lowers tiers – even catastrophic failure which results in vulnerable users experiencing the withdrawal of essential public services. In part, this is no doubt a reflection of, and is reinforced by, the fact that local public services in the US are largely funded by local taxation. In Britain, successive governments have taken the view that as most of what councils do is funded by national taxation and mandated by national statutes reinforced by ministerial guidance, government has a legitimate interest in how the money is spent and in how local services are delivered.

But in England, we’re now clearly witnessing some change. The planned demise of the Audit Commission, the probable limitation of the scope of public sector audit and the abolition or scaling back of various inspection regimes in local government suggests that the government does not attach the same priority as its predecessor to activities that can provide early warning of impending failure in public services, allowing scope for ministerial or other intervention to protect the interests of service users. There is clearly now a greater appetite for risk, a greater willingness to tolerate failure.

But would ministers tolerate a failure of Jefferson County proportions? And even if they felt so inclined, would the media and the electorate allow them to do so? We’re all in favour of localism, at least up to a point, but where is that point? Just how far are we willing to see local services collapse before we demand that ministers take action? And how long are ministers willing to stand back and witness serious financial or service failure in the public sector before feeling the need to intervene?

**Appetite for risk**
What has been absent so far from the debate about the future of public audit and inspection is any real debate about our appetite for risk. This will quite properly change over time and will be influenced not just by political philosophy but also by the cost of providing different levels of assurance and competing demands on the scarce funds available to meet that cost. But we should always have some understanding of what our risk appetite is.

In the open public services white paper, published in July 2011, this issue was touched on, but largely flunked. There is much to be applauded in its emphasis on extending consumer choice and supporting this with better information and more robust local accountability mechanisms. But the white paper also says:

> “However, in the transition to achieving full individual choice there will continue to be a need for the government to intervene in cases where providers are failing to meet minimum standards or failing to make adequate improvements (‘coasting’). For example, in education the government should retain the responsibility and authority to act in cases where poor standards or coasting means that a public sector school needs a change of control.”

So there are limits to localism. The government will not tolerate ‘coasting’ in education. But will it do so in highways maintenance or library provision? And in the absence of inspection, how will it know when coasting is taking place?

Of course, no-one is going to die as result of receiving a poor library service; but if there is a catastrophic financial failure in a local authority,
Tolerating public service failure

the government will be faced with a choice of either picking up the bill or letting some services collapse. And it would be helpful to know how it will decide.

A view from the sector?

Even better, it would be sensible for the sector itself to have a view. What exactly is an essential local government service and how much of it is essential? During periods of industrial action in the fire service we tolerate a lower level of fire cover than we normally receive, but clearly we would never tolerate the complete withdrawal of fire services. And although we might all agree that social care for the elderly is vital, we accept the failure of service providers such as Southern Cross because they operate in a market in which others are available to meet essential needs.

The proposed failure regime for the health service envisages that hospitals may go bankrupt in circumstances where some services will be transferred to other providers or be kept going by the regulator, while others will simply be allowed to disappear. Clearly, in respect of the NHS the government has thought about these issues carefully.

But where is the parallel thinking about its tolerance for the higher risk of failure in local government that will come from the abolition of the Audit Commission and the scaling back of inspection?

We are apparently on a journey towards greater localism, which is good news. But we need to know if the destination is Jefferson County or somewhere closer to home.

Steve Bundred is the former chief executive of the Audit Commission. He is currently working as a consultant and in a number of advisory and non-executive roles relevant to the provision of public services.
We have to change to stay the same

Rudi Turksema calls for public audit to recognise the need to change in order to deliver its key functions in a new context

“I have to change to stay the same”. This quote by Willem de Kooning, a famous Dutch painter, also describes the challenge that public audit bodies face. Public audit nowadays cannot be compared to public audit of, say, 25 years ago.

Two developments have been particularly important: the emergence of a networked society and the global financial crisis. We need to ask how such developments affect the work of public auditors, and how public audit can change in order to stay the same.

A networked society

Increasingly, our society can be characterised as a networked society. The influence of Europe on national policies, the decentralisation of policy implementation and the social media revolution have significantly changed the landscape of public policy making. Such developments affect the work of public auditors. Twenty five years ago, the accountant or auditor was seen as an authority. Whenever we published an audit report – after several months of meticulous and rigorous scrutinising – it could make a serious impact on the executive. Nowadays, in the connected, open, 24/7, and online society, a “tweet” can have much more impact than an audit report, and public audit is just one of the many voices that try to influence the executive or media.

Within this networked society, there are three key challenges which need to be addressed by public auditors:

- managing for results and performance-based budgeting
- the impact of “open government” and greater transparency
- how to add value in a system where information is so easily accessible

Results-based management / Performance-based budgeting

Managing for results can be quite complicated in a networked society. Both centralisation (an important regulatory role of the European Union) and decentralisation (of policy delivery to, for example, local government and quangos) have changed, and in some cases limited, the role of national governments. To a large extent, these shifts in power are for the better. However, a possible downside may be that significant parts of the public budget are no longer subject to the same degree or clarity of public control, or they may be subject to only fragmented public control. This makes it necessary for public auditors to seek greater collaboration and share knowledge with their colleagues at both national
We have to change to stay the same

and international levels. Where significant fiscal transfers take place between levels of government, there is a risk of a loss of overall transparency in how public money is used, and whether it is deployed effectively. Collaboration between public auditors of those different levels of government is one key instrument for repairing that potential loss.

Open government

The “open movement” that can be seen in many countries contributes to greater public accountability. Increasingly, interested citizens demand – and get – access to information and data that were previously ‘safely’ put away in the administration and databases of government. Moreover, in the future, information will be continuously available, in streams of data. Interesting examples can already be found in the UK (data.gov.uk) and the US (recovery.gov).

Such examples demonstrate an explicit interest in public accountability on the part of citizens. The public auditor has to be responsive to such developments and reflect on both how this affects their work and how they can benefit from the work of these “armchair auditors”. There is a need to focus more on filtering out from this potential mass of data the information that is relevant for public audit purposes. This in turn has implications for the skills required by public auditors - expertise in social media, advanced data analysis, and data visualisation are just some the new skills they will have to learn.

Critical friend

In a networked society, the question of what value is added by public auditors becomes increasingly important. The growing availability of information, coming from many different sources, means that public auditors are no longer in an exclusively privileged position when it comes to providing clients with information on policy outcomes. Policy makers and politicians may no longer be dependent on auditors as their providers of (more or less) independent evidence. Public auditors need to re-evaluate their role. One possible future role is that of a “critical friend” helping clients to navigate the information overload and pointing them towards more efficient policy making and delivery.

The global financial crisis

At present, the sustainability of public finances is clearly one of the most important issues in the public sector. More than before, it is of great importance that public auditors point the executive to opportunities to make better use of public resources through better regulation, smarter ways for policy delivery, and disseminating good practices.

It is also the role of the public auditor to check how government is dealing with the financial crisis. Currently, billions of public euros are made available to prevent the financial markets from collapsing, and countries from bankruptcy. But are such flows of money sufficiently subjected to external control and audit? Several European supreme audit institutes have concerns whether this is the case and have called for improvement in the external controls provided by the European Stability Mechanism. In the Netherlands the Court of Audit acted proactively and sent a letter to the Parliament, pleading for the necessity of sufficient public control on such measures, and they strengthened the message further through associated media appearances.

The financial crisis – and especially the speed at which major decisions are being made – necessitates that public auditors should take a more proactive role if they want to contribute optimally to public accountability. They cannot simply stick to the traditional role of ex post facto examiner of financial accounts which include decisions that will have significantly affected a country’s budget, the accountability for public finances, and the health of governments’ financial accounts.

Implications for public audit

The networked society and the global financial crisis are two major issues that have profound implications for the work of public auditors. I think the public audit community should embrace them and see them as a welcome influence
on the work of public auditors. Public auditors themselves are not guided by an 'invisible hand' or confronted with external control, so they need such ‘shocks’ to their system and thinking. These issues point to new questions and opportunities. They create the need for innovation, and they should prompt public auditors to ensure that they think about whether they are fit for purpose; and that they make sure to change in order to stay the same.

Dr Rudi Turksema is performance audit expert at Netherlands Court of Audit. He is responsible for performance audit, advice and guidance and has published on issues such as the selection and planning of performance audits, the quality of non-financial information and evidence-based policy.
There has been a considerable amount of media attention given to the fiscal deficit and sovereign debt challenges in Europe and the US. While Greece has dominated the news and faces the most serious and immediate challenge, it is not the only country that must make tough choices in order to improve their financial condition and longer-term fiscal outlook. In most cases, when you closely examine key trends, the fiscal challenges that major countries are facing, are likely to increase in a future absent of serious structural reforms.

Why? Because of known demographic trends, rising health care costs, large social insurance programmes, underfunded pension and retiree health plans for public employees, and increasing global competition. These and other factors will result in escalating spending coupled with additional constraints on the ability to achieve future revenue increases.

Given the above trends and challenges, it is clear that many governments will need to engage in a range of transformational reforms regarding what government does, how it does it, and how it finances its operations. This will require much more emphasis on performance, projection and comparative information.

For example, in the US, the federal government has grown from 2% of the economy in 1800 to about 24% today, and is projected to rise to 37% by 2040, unless there is a major change of course. If you add state and local government, the public sector will be more than 50% of the US economy in 2040. This is both economically undesirable and culturally unacceptable in the US.

The growth of government
The growth of government in the US is driven primarily by a range of off-balance sheet obligations that will exacerbate future deficit and debt challenges. At the federal level, these include a range of social insurance programs - most of which are targeted to support the elderly (e.g., Social Security and Medicare). These two programmes alone are underfunded by at least $46tn dollars on a discounted present value dollar basis. That is more than three times annual GDP in the US and this number is growing much faster than GDP.

At the state and local level, most governments face huge off-balance sheet obligations associated with underfunded pension plans and unfunded retiree health obligations for public employees. In addition, unlike the federal government, states and localities cannot print money.

The current and projected fiscal imbalances of sovereign nations and other governmental entities call for changes to current accounting/
reporting and auditing standards as well as expanded application of existing standards. With regard to annual reporting, in my view, in order for any governmental annual report to be meaningful, it needs to include financial position, financial results, financial projection and other key performance information. Such performance information should be outcome oriented to the maximum extent possible. All such information should include current results, recent trends, and comparative information in order to provide a full and fair perspective of the reporting entity's position and prospects.

In order to modernise the public sector accounting and reporting model, standards need to require certain unfunded obligations (e.g., pensions, retiree health care, intra-governmental debt where an exchange has occurred) to be included on the balance sheet. Furthermore, additional statement and disclosure information is needed in connection with projection and performance information. This includes the need to highlight the intergenerational implications of the government’s current policy path as well as comparative financial and performance information to provide contextual sophistication.

**Sovereign fiscal responsibility index**

With regard to comparative information, in 2011, the Comeback America Initiative, partnered with masters degree students at Stanford University to develop the first ever Sovereign Fiscal Responsibility Index (SFRI). The SFRI is a type of “fiscal fitness index” for countries. The SFRI rankings consider three key factors: fiscal space, fiscal path, and fiscal governance.

Fiscal space compares a country's current debt/GDP levels, including how much the country relies on foreign players to finance its debt, to a theoretical limit (as per various IMF studies). Fiscal path considers future projected levels of debt, including how many years a country is from hitting that theoretical limit. Fiscal governance considers the legal, institutional and other controls that are designed to help ensure fiscal prudence, and whether or not such controls are transparent and enforced.

Given the above factors and based on IMF data, the most current SFRI rankings show Australia as number one and Greece as last of 34 major industrialised nations. The UK is ninth, while the US is an embarrassing number 28 - down dramatically from what its ranking would have been 10 years ago if the SFRI had existed at that time.

**The role of public audit**

As we look to the future in connection with governmental auditing, several things seem clear. Auditors of government entities need to make greater use of emphasis paragraphs to highlight serious structural fiscal challenges that need to be addressed. I did this in connection with the US government's financial statements when I was US comptroller-general and head of the US Government Accountability Office (GAO). Auditors should also assume more responsibility for reporting on the reporting entity’s system of internal controls. GAO voluntarily did this when I was comptroller-general. In addition, auditors will have to consider any projection and performance information and appropriately address such information in their audit report. Importantly, auditors should not be expected to assume the same level of responsibility for such information and that needs to be made clear in the audit report.

In summary, many, if not most, major governments face serious financial, fiscal and operational challenges. The accountability profession needs to promote more transparency and accountability in order to help facilitate broader public understanding and accelerate needed reforms. It also needs to accelerate modernisation of current accounting/reporting and auditing standards and practices. The accountability profession should also lead by example and practice what it preaches. If these things happen, our profession can add more value and help to make sure that our collective future will be better than our past.

*Hon. David M Walker is founder and CEO of Comeback America Initiative. He was seventh comptroller-general of the US and head of the US Government Accountability Office (1998 – 2008)*
A Greek flag flies next to a statue of the ancient goddess Pallas Athena on the roof of the Academy building in central Athens. Greece is not the only country having to make tough choices. Photo: EPA
I joined the National Audit Office (NAO) as comptroller and auditor-general in 2009 following a long career in the private sector and, latterly, as the commercial director of the Ministry of Defence.

As you’d expect, upon my arrival I was thoroughly briefed on the history of public audit and of the NAO, including that the first ‘Auditor of the Exchequer’ to scrutinise government expenditure was mentioned back in 1314. I’m proud to continue this tradition. But I admit to being more interested in the future of public audit than in its past. In the corporate context, I have seen that audit can provide important insights that improve results. In the public sector, it can help government, national and local, to become more effective. Audit can add value.

The longstanding objective of public audit – to subject public spending to effective scrutiny – is one I completely support. This goal is particularly important today as economic and financial challenges drive major changes in the size and shape of our public services. Cost reductions and greater diversity of provision are forming networks of public services that are far more complex even than 20 years ago. As the planned changes to public audit are debated in Parliament and through this publication, I am committed to ensuring that independent scrutiny, supporting the Commons public accounts committee, and the search for value for money, achieved collaboratively with the bodies we audit, continue to underpin all our work. In this way, I expect public audit to identify improvements in the way public money is used and in the way that public services are run.

Changing expectations
To provide scrutiny, public audit must be based on a rigorous, clear methodology that is consistently applied. But audit can only support improvement if it is able to reflect and adapt to the reality of the world being audited. For example, over recent years, we have seen a need to achieve significant savings, new back office models, more partnership working to deliver services, and the greater involvement of the private and voluntary sectors in public services. Collectively, these changes are significant, and they need to be reflected in our audit approach. More and more of the NAO’s studies are therefore focused on cross-cutting issues that respond to the challenges faced by the bodies we audit. Hence, we’ve published seven reports on cost reduction programmes in government, five on the government’s IT challenges and we
Scrutiny and improvement: the evolving role of public audit

are planning reports in 2012-13 on how spending decisions are prioritised and how high-risk projects are managed. This work aims to provide insight that all public bodies can draw on as they tackle the challenge of spending public money effectively.

Nonetheless, I’m realistic enough to know that asking tough questions of public services as they deliver in difficult circumstances is not always welcome. I’ve experienced first-hand the complexities of managing long-term spending decisions; to have to respond to auditors’ questions at the same time can be an additional burden. It’s sometimes necessary to look back to make sure that lessons are learned, but I’ve also focused the NAO on examining projects at an earlier stage of delivery so we can look ahead and reduce the risk that things might go wrong later. For example, we have published six reports on the London 2012 Olympics and Paralympics – the first in February 2007, over five years before a foot hits the track – identifying the issues and challenges that need to be managed.

Whether they operate nationally, locally or both, public bodies face common issues where auditors can provide expertise, including around how to manage finances, risk and information in order to provide high-quality services cost-effectively. Over many years, local authorities have consistently demonstrated their capacity to manage change and deliver efficiencies. Central government departments are making improvements too. Auditors can play a role in ensuring that, where similar problems are faced, with fewer resources available, public bodies can learn from each other’s good practice. The NAO’s ability to transfer to the bodies we audit the knowledge that we gain around the public sector will be an important mark of our success as public audit evolves.

Local audit

I intend to bring this approach to any changes to the NAO’s role as a result of the government’s proposed reform of local audit. Local authorities are set to appoint their own auditors and, subject to Parliamentary approval, the NAO will prepare the Code of Audit Practice. But key aspects of the current audit framework will remain: local auditors will still deliver audit against the Code; they will still consider the individual authorities’ arrangements for delivering value for money; and they will still have a duty to report in the public interest when required. It is as important that local residents are able to scrutinise their council’s spending decisions as it is for Parliament, on behalf of national taxpayers, to scrutinise decisions made by central government.

As we explore the value for money of public services, I also intend to contribute as much information as I can to help local bodies as they make their spending decisions. We regularly report on issues relating to local services. Last year, for example, we looked at the oversight of financial management in local authority maintained schools and the issues affecting the achievement of Foundation Trust status by hospital trusts. We are shortly publishing a report on the effectiveness of communications between central and local government, and plan to undertake further studies in 2012-13, including on community budgets and the financial resilience of local authorities, that aim to help all public bodies to work together more effectively to achieve common goals.

While I will not audit local authorities nor appoint their auditors, I won’t be at arms’ length from the sector. I’ve already met many council leaders, chief executives and finance directors, and I’ve appointed senior finance directors from local government and health to key roles within the NAO to help develop our work. I am also establishing a Local Government Reference Panel, liaising with the LGA, SOLACE and others to help us develop our plans into a sensible, effective approach to local audit. I am of course also working with central bodies, including the Department for Communities and Local Government and the Audit Commission, to ensure that the transition in audit arrangements is as smooth as possible. Scrutiny is important, but for improvement to happen, reporting burdens on local government must also be appropriate.
Conclusion

I've valued the conversations I've already had with local government. I have been impressed with the sector's clarity about where public audit can add value, and where it may not. This realism is wholly positive. I wholeheartedly stand by the long tradition of public audit in scrutinising expenditure. But I will also focus attention on how public audit can help drive improvement by carrying out evidence-based work on issues where we have expertise and experience to offer. In this way, I expect the future of public audit in the UK to be true to its past.

Amyas Morse was appointed comptroller and auditor-general, National Audit Office in June 2009. He is a member of the Institute of Chartered Accountants of Scotland
According to Francis Fukuyama, the origins of political order are constructed on three pillars: the presence of effective state institutions; the operation of the rule of law to constrain political power and corruption; and the accountability of government which compels the state to use its power in accordance with public, transparent rules.

The Greek and Roman republics, ancient China, India and western European states all developed different political systems because of the differential development of these three pillars.

Public trust, accountability and good governance go together. “Public service is a public trust. Public service ethics are a prerequisite to, and underpin, public trust, and are a keystone of good governance.” (OECD)

Public trust in challenging times

However, we live in challenging times. In 2010/11, across the 27 member states of the European Union, according to Gallup, a median of 36% of the population were confident in their government (Gallup poll). In the UK, public trust in MPs continued to hover around 26% (Committee for Standards in Public Life). In the US, a Gallup poll showed that 82% of Americans disapproved of the way Congress is handling its job, and confidence in the people who run for or serve in office dropped from 66% of the population in 2008 to 45% in 2011 (Gallup).

As the complexity of modern government increases in response to the expectations of citizens and the challenges of the economic, social and ecological environment, it becomes all the more important to maintain public trust. The idea of public trust is central to the fiduciary relationships that run throughout modern government – relationships between the state and its citizens and between government, as provider of services, and service users and taxpayers.

Fiduciary trust is an important component of public trust in Government (Thomas). Agents of the state – councils, health authorities, and public bodies generally – must be trusted to carry out their duties efficiently, effectively and without taking advantage of their privileged position. It is often difficult for citizens to know all that public bodies are doing. There are well-known asymmetries of information that are endemic in principal-agent relationships.

If we recognise that public trust is essential for the proper and efficient working of the state in a complex and challenging world, we must be clear about the conditions that can engender this trust.
First, it is essential that there is a commitment by elected representatives and public officials to good stewardship. This is about efficiency certainly, but stewardship also must include adherence to ethical standards and explicit norms of justice.

Second, the many professional organisations operating throughout the public sector must give out clear signals that they do not define their responsibilities to their members in terms of self-interest. They must commit to public service via rules and codes of conduct which are transparent and enforced.

Third, the necessary conditions must be in place for effective and trusted audit, regulation and inspection. Arising from a concern to promote and sustain effective and trusted audit, the heads of the public audit agencies in the UK set out core principals of public audit which should be applied across all activities of the state:
- Public sector auditors should be independent from the organisations being audited
- Public sector auditors should operate with a wide scope. In addition to the audit of financial statements, public audit should be concerned with regularity (or legality) and with propriety (or probity standards)
- Public sector auditors should also conduct performance audits to provide independent analysis and findings on whether public bodies are providing value-for-money
- Public sector auditors should be required to make the results of their work available without restriction to the public and to elected representatives.

Public audit and public trust in Scotland
These principles were promulgated in 1998 and were endorsed by both Westminster and by the Scottish Parliament. For example, the auditor-general for Scotland is appointed by the Queen on the nomination of the Scottish Parliament, and the auditor-general (through Audit Scotland) appoints the auditors of devolved public bodies. This ensures the independence of public audit. Appointed auditors must work to a Code of Audit Practice which includes a description of the wide scope of the audit work and the requirements for public reporting. There is a rolling programme of performance audits across the public sector, with reports being formally considered by the Scottish Parliament. The findings quite often receive wide media coverage. It is not uncommon for opinion pieces in newspapers to give favourable mention of the work of Audit Scotland, which is perceived to be acting in the public interest.

The application of the core principles of public audit in this way has contributed to public trust in Scotland. A recent Ipsos Mori survey of over 80 members of the Scottish Parliament found that Audit Scotland was one of the best-known and most favourably regarded organisations (both public and private sector) in Scotland.

In 2010 just over 60% of the Scottish population trusted the Scottish government “just about always” or “most of the time” to act in Scotland’s interests (Scottish Government). This is significantly higher than the similar percentage for the UK government - but achieving trust at the UK level may be more difficult because the lines of accountability are more diffuse and complex.

It has been suggested that local and regional agencies are generally more trusted than federal agencies on local issues (Thomas). The Scottish Parliament designed its procedures around the principles of openness and transparency, and this may have contributed to a higher level of public trust. In the devolved regions and at the UK level, the public’s confidence in the good governance of the state will be buttressed by the profile of public audit agencies like Audit Scotland and the National Audit Office, which independently and publicly report on financial stewardship, legality, standards and performance across the public sector.

Conclusions
I would draw two conclusions for public auditors, and regulators generally.

First, society’s trust in any professional group is hard won over a long period. Public auditors and regulators are no exception. The build-up of this trust can become a form of social capital, which can enhance the standing and effective-
Public audit, public trust and good government

ness of public auditors and contribute to public trust in the good governance of the state. But the trust, which is hard won over time, can be easily lost. The question “who guards the guardians?” is an important one, not only for the immediate agenda of an individual audit body or regulator, but also in relation to public trust in the wider governance system. The greater the independence entrusted to a public auditor or regulator, the stronger should be the governance arrangements for overseeing and reporting on their probity and proper use of public money.

Audit Scotland, for example, has a board with a majority of non-executive members who are appointed by the Scottish Parliament and an external auditor also appointed by Parliament. In addition, the auditor-general is accountable to a Commission of members of the Scottish Parliament for the budget requirements, use of resources and business performance of Audit Scotland.

Second, we must not neglect the watchdog role of public auditors. This must remain “core business.” It is right that stakeholders in government should ask challenging questions about the public value of audit. However, it is important to recognise the public value of public trust, which can be engendered and safeguarded by having an audit regime which is clearly independent of government. There is a current expectation from government that audit should do more to support improvement. Public auditors are capable of responding well to this challenge but in doing so, they must jealously preserve their watchdog role. The strapline over Audit Scotland’s Corporate Plan 2012/15 is carefully worded: “Helping to improve by holding to account.”

Robert Black is the first auditor-general for Scotland. His previous post was controller of Audit for Scotland and in his earlier career he was chief executive of Tayside Regional Council and Stirling District Council.

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Successive Welsh administrations since devolution have continued to diverge from Westminster in a number of significant policy areas. Their approach to the use of internal markets has undoubtedly been different. They have also been reluctant to use league tables or comparative data in a way that overtly stimulates competition between public sector bodies; preferring to develop collaboration and shared learning. With the Welsh Government’s new law-making powers, this divergence may well become more marked.

Wales’s relative size presents a unique set of challenges and opportunities. The dominance of the London-based media means that getting across Wales-specific issues to the Welsh public is sometimes an uphill struggle. The scale and complexity of collaborative endeavour in Wales also makes the elector’s decisions more difficult. Public audit has a key role to play here, to help people understand the roles and responsibilities that underpin Welsh public life, so that they can more effectively hold public bodies to account.

Overall, there has been a real-terms reduction of £1.6bn in devolved funding between 2010-11 and projected budgets for 2013-14. The Welsh government has prioritised spending on ‘frontline’ areas, with its own ‘back-office’ spending facing the largest reductions. However, there are concerns regarding the pace of the modernisation of services in Wales.

In relation to health services, there remains a lack of political consensus to make difficult decisions and balance the local delivery of services with the concentrations of skill and attendant economies of scale necessary to deliver high quality specialist services. As auditors, we have repeatedly stressed our concerns about the ability of health managers to provide services within their budgets. These budgets were comparatively generous following devolution but, there has been a sharp shift in recent years. This financial year, the NHS in Wales faced the toughest financial settlement of any of the countries of the UK, and needed extra funding from the Welsh government. Local government, in contrast, has seen lower reductions to its funding from central government than in other parts of the UK.

Wales is exploring a range of shared and innovative service models and this agenda has the potential to change radically local government delivery patterns across a wide range of functions in which the third sector is increasingly emphasised as a partner. The empowerment of the individual has also been prominent, particularly in areas such as health promotion and environmental protection. In education, there is a strong

Part of the whole: public audit and the Welsh public service

Public auditors must lead by example and assure citizens that good governance runs from top to bottom across all services says Huw Vaughan Thomas, auditor-general for Wales

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emphasis on improving parenting skills and on early learning. But as the last PISA assessment of educational attainment showed, Wales’ position behind England, Scotland and Northern Ireland has further deteriorated. The Welsh government Minister for Education has made integration of school improvement services a key plank of his action plan to improve the position.

The question as to the relative effectiveness of these approaches in improving quality of life may not be resolved for decades.

Public Audit – meeting the challenge
How is public audit in Wales responding to these challenges?
First, I believe we must lead by example. We have already reduced our audit fees across Wales in cash terms by £1.27m (8%) between 2009 and 2011 and I am committed to making further reductions where possible. On a cumulative basis between 2009-10 and 2012-13, I expect to deliver a real terms reduction in total annual expenditure on audit of close to 25%. My focus, however, is on building a proportionate, audit regime, solidly founded on the recognised principles of public audit, that itself represents excellent value for money and takes advantage of my ability to follow the public pound across the Welsh public sector.

The Wales Audit Office (WAO) plays a prominent role in pan-sector work to achieve increased efficiency, with improvement, through innovation. Its work identifies potential savings for public bodies, and our focus on helping public bodies release money to the frontline through more efficient management of the corporate ‘machinery’ continues to be a strong theme.

We have consistently highlighted a real strategic gap in terms of guidance and direction on managing public service reductions. In delivering savings, service providers do not always plan collaboratively. They often fail to take account of the impact on service users or anticipate the unintended consequences for other public services so that they can mitigate the impacts of cuts. Recognising the need for support in this area, we have, for example, produced a Cost Reduction Guide, to help public services in making these tough choices.

Helping decision makers
I am resolved to help decision makers achieve well thought-through risks and avoid an unduly risk-averse culture. Our Good Practice Exchange helps public services learn from each other: it provides a view of how Wales compares with services elsewhere. The WAO’s work is developing an increasing emphasis on the tensions between central and local government approaches, tensions that often hinder improvement. We are also providing independent yet real-time commentary to support providers and policy makers.

A thorough and well-evidenced retrospective review can offer considerable insight into the underlying causes of poor performance or governance. But, it is sometime better to offer a prompt, albeit a more limited picture, to inform decisions as they are taken, as well as providing appropriate post-event review.

Auditor independence
The independent appointment of public sector auditors is a central plank in guaranteeing appropriate audit independence, and there are clear advantages in using the market to challenge in-house audit supply and keep it fresh. In my forthcoming contracting exercise, I will continue to outsource around a third of audit work and will seek to diversify supply, particularly in relation to performance audit work. Public confidence is easily lost and difficult to regain and the need for robust audit of smaller bodies, such as town and community councils, must not be underestimated.

Misuse of relatively small amounts of public money can cause disproportionate local interest and concern. A recent WAO report on grants management highlighted a range of high profile...
Part of the whole: public audit and the Welsh public service

projects and initiatives that we have investigated in recent years. Many of them involved community councils and local not-for-profits groups and it is unlikely that these issues would otherwise have been examined in the public domain. Wales makes significant use of grant funding and in this important report we drew attention to the failure by funders to address a range of serious issues over a number of years. In times of plenty and restraint, it is the role of the public sector auditor, as a key player in an increasingly integrated Welsh public service, to provide assurance to citizens that good governance and effective use of resources underpin their services.

Huw Vaughan Thomas is auditor-general for Wales and has served as private secretary to the Parliamentary Under Secretary of State for Employment and as the Department of Employment’s Regional Director and Director for Wales
Public audit in hard times

In these financially turbulent times trust is crucial, says Jan-Eric Furubo, and so is independent public auditing, especially from institutions that scrutinise activities

The world has clearly become a very turbulent place. Political turmoil and financial crises have shaken many notions about government and public administration, and also about public audit. Many of our ideas about public audit were shaped in societies which were much more stable and in which change processes were assumed to be incremental. We need to re-think these ideas for a new context.

Limits of auditing

Today, we have to identify the role of audit in a world where decision makers will often find that the road they took previously is now blocked and that they have to do something very different. The problem is that many of our ideas about the role of knowledge in decision making are based on the notion that we can do the same things today as we did before, and which we intend to do tomorrow.

The language used in fields like public administration and policy learning tends to imply that we understand the policies and tasks of governments and other enterprises as ongoing. We see them as sequential processes, often describing them as circles with elements that can be foreseen and planned for in advance, such as identifying alternatives for future action, analysing costs and benefits, choosing from options, implementing them, monitoring and evaluating them, identifying possible changes and so on.

This is familiar terrain. We can rely on earlier experiences. Moreover, this is a sort of ideal-type of rationalistic decision-making in which it is easy to grasp the role of audit and evaluation. We assume that we will know which information is relevant when we want to judge the success of different elements of an intervention. Even if the environment in which the intervention takes place changes, we know - or assume that we know - what changes are important to observe. But in fact we will find that we need a very different form of knowledge in turbulent times than in periods where the earlier courses of action can be assumed to continue.

In addressing new priorities and new actions in times of rapid change, knowledge from earlier policy frameworks and earlier ideas is less relevant. Uncertainties are deeper and the questions asked by decisions makers are much more about alternatives than about what went before. In creating new policies fit for an era of change, the new instruments and the new institutions that need to be constructed are not about what worked before. Rather, they must be constructed by identifying the best possible knowledge that
Public audit in hard times

Public audit in hard times can be of use in discussing alternative and innovative solutions.

**and the importance of auditing ...**

In the auditing context this need for new knowledge and new questions can be a constraint because auditors are often more comfortable with existing methodologies and sources of knowledge. But it also makes it important to focus on what is the unique importance of auditing. Turbulent times make tough decisions unavoidable. Tough decisions also have tough consequences on the lives of ordinary citizens, and such decisions are possible only when there is trust. Trust is therefore of greater importance in turbulent, non incremental, times than in stable times.

This brings us to the fundamental role of auditing in balancing an important contradiction in democratic societies. In all societies power can be misused and ‘mistrust’, as well as a willingness to question and if necessary confront, is an important point of departure in challenging such potential misuse of power.

We know that people and bureaucratic systems act differently if they know that they are scrutinised. Such challenge supports desirable values and enhances good behaviour in society, and this generally leads to better decisions and encourages better behaviour in government organisations. At times of change better decisions are needed not only in the handling of public money, but also in the performance of public services. It is therefore important that the scope of auditing is broad enough to cover aspects of performance as well as those covered by traditional financial auditing.

On the other hand, too much distrust will reduce the efficiency of the democratic institutions and could undermine the democratic system, which depends on a degree of trust to function effectively and efficiently. This contradiction between the risk of abuse of power and the need for an (appropriate) degree of challenge and of ‘mistrust’ can only be solved by enhancing accountability. Institutions which, in an independent manner, scrutinise governmental activities and underpin that accountability are therefore essential.

That is the critical role of public audit. And because the efficiency of the democratic institutions, and their capacity to change courses of action and make difficult decisions, are more important in turbulent times than in times where everything runs smoothly, auditing becomes more important in hard times.

**.... based on its independence**

So, trust is crucial in turbulent times and that means that public auditing is more important also. But if we need institutions which scrutinise governmental activities from an independent position then when it comes to audit institutions, independence is not a quality which sometimes can be attributed to individual reports. It is, rather, a part of the definition of what audit is always about. Without independence we cannot talk about auditing. This insight is crucial. Independence can also be important or useful in other forms of evaluative activities, such as program evaluations or studies aimed at improving the practice of public administrators. But for audit, independence is absolutely critical.

Jan-Eric Furubo is auditor-director, Swedish National Audit Office. He has published widely onevaluation methodology, the role of evaluation in democratic decision making processes and its relation to budgeting and auditing.
The proposed changes to the local public audit regime provide the opportunity to reassess the reporting aspects of external audit. A range of potential changes are also being considered for the private sector audit market. These include how the views of auditors about their financial services audit clients can be shared with regulators.

Most large companies and groups have formal audit committees, comprised of non-executive directors, to oversee the external audit process, from the design of the audit plan to receiving reports on the outcome of the statutory audit. All the communications between the auditor and the audit committee are in private, despite the fact that the auditor is required, by the Companies Act 2006, to report to shareholders, rather than to management or the board of directors.

The only explicit communication shareholders receive from the statutory auditor is the formulaic audit report, which includes the standard professional opinion on whether the annual financial statements give a true and fair view. This seems a poor return to shareholders for the often considerable sum paid for the audit.

In the case of financial institutions, there is now agreement that there needs to be some two-way dialogue between the auditor and the regulators about areas that may be of concern. These could cover the sustainability of a client’s business model, the aggressiveness of accounting policies or responsiveness to control weaknesses.

There is no doubt that, in going about their work, auditors gain a considerable amount of information about their client. They will also form judgements, for example, about a client’s way of doing business, the quality of its management and its financial viability. The only assurance that an auditor provides, however, is the standard opinion in the audit report. Except where they are directly involved in a business, shareholders do not have access to these additional insights which the auditor can provide.

The proposals that auditors meet with regulators of financial services clients still does not address the issue of the communication line between auditor and shareholder. In fact, there is a clear danger that regulators will have access to more information from the auditor than shareholders, which seems to go against the statutory accountability of the auditor to the shareholder.

Auditor liability risk

One of the main reasons why auditors have resisted moves to report in a more long form manner or to permit public or shareholder access to their written reports to audit committees and...
Public audit – how transparent can it be?

boards of client companies is the liability risk. A lengthy process of consultation led to the updating of the Companies Act 2006 provisions relating to external audit, which now permit limitation of liability for auditors. However, there are few signs that client companies are prepared to enter into formal engagement terms with their external auditors that provide for such proportional liability protection for the auditor. Hence, it seems that shareholders, and other stakeholders, will have to wait for further change on auditor liability provisions before we are likely to see more qualitative and explicit reporting by the external auditor to shareholders.

For the public sector, there are similar arguments for the auditor to report more in public, but the same liability issues apply. Public bodies invariably have multiple stakeholders. For government departments and agencies, arguably, the auditor should report to the taxpayers as much as to a permanent secretary, ministers and Parliament. For local authorities, the external auditor has implicit responsibilities to council taxpayers and the wider community as much as to executive officers and elected members.

Audit reporting practice in the public sector has changed over recent times. Some years ago, the Audit Commission required its appointed auditors to produce and publish a lengthy management letter, including the auditor’s views on a range of issues from accounting policies and internal controls to assessment of financial trends and performance. These management letters were often very well received by NHS and local authority clients, because they set out the informed, evidence-based, views of the auditor, and often included useful comparator information. However, they took considerable time to prepare and, ultimately, the pressure for lower audit fees meant that they were no longer required.

The reporting dilemma

We are therefore faced with a dilemma where there is clear demand from stakeholders to have access to the views of the external auditor but there are serious barriers of liability risk and cost that prevent these views being formally shared.

From time to time, most audit committees hold private sessions with their external auditors, without officers or executive management present. Committee members seek the auditor’s views on a range of matters which provide useful insight. Areas often explored are the responsiveness of management to audit recommendations, the behaviour of client staff to audit challenge, the amenability to alter draft accounts and disclosures, the technical competence of the finance team, and whether there is a tendency to optimism bias in financial reporting.

The more effective audit committees are seeking to get some added value from the external auditor through such enquiries. The real challenge is whether external auditor insights, in both the private and public sectors, can somehow be made available to key external stakeholders. One way could be for the section on governance in the annual report to include, in the report on Audit Committee activity, a summary about these discussions with the external auditors and their outcome. At least that would go a small way to lifting the veil on what professional judgements external auditors may have arrived at as a result of their labours.

With so much of the audit activity and reporting done behind closed doors, there remains the danger that external stakeholders and commentators fail to appreciate all the added value that an auditor provides to their clients. The formal published audit report does nothing to convey the knowledge gained, the issues experienced, the audit challenges made and resolved, nor the supporting evidence behind the underlying professional judgements arrived at. It is to be hoped that the current period of change for external audit arrangements in both the public and private sectors does not pass without a thorough reassessment of how, and to whom, auditors report the outcomes from their labours.

Nigel Johnson is recently retired lead public sector audit partner at Deloitte LLP after a long and distinguished career in audit and advisory work.
The problems with top-down performance frameworks have been well rehearsed. External assessments are costly. They can encourage a compliance mentality and are susceptible to gaming. Targets often reflect national rather than local priorities. Indicators focus on what is measurable as opposed to what matters. Star ratings imply a one-size-fits-all approach which belies their sensitivity to the weightings attached to different dimensions of performance. The reporting mechanisms increase central government control but do little to encourage greater accountability to local politicians, citizens and service users.

The architects of comprehensive performance assessment (CPA) argue that it acted as a powerful force for change, uncovering performance problems that would have been overlooked in the past. But they also acknowledge the limits of ‘terror and targets’. Former Audit Commission insiders admit that early CPAs plucked much of the ‘low hanging fruit’ and subsequent assessments brought diminishing marginal returns. The process was not proportionate, and failed to deliver genuinely joined-up working with the other local inspectorates. But the question is whether self-improvement will fare any better and the answer will depend on whether it tackles three key issues - cost, capacity and credibility.

Cost
Cost ought to be an easy win for self-improvement. There is widespread agreement that approaches like CPA and comprehensive area assessment (CAA) are unaffordable in an era of austerity. The new arrangements are not, however, without costs of their own.

For a start central government departments still require councils to submit copious amounts of performance data (see, for example, the fascinating exchanges last September between Dame Helen Ghosh, Sir Bob Kerslake and Sir Nicholas Macpherson and the Commons public accounts committee in the course of the committee’s enquiry into localism and accountability).

Second, regulatory bodies Ofsted and the Care Quality Commission are alive and kicking. So the direct costs of employing their staff and resourcing their site visits remain, as do the demands they place on local authorities – for data, access to personnel and responses to reports.

Third, no one is suggesting that councils will operate in an evidence vacuum. Self-improving authorities need relevant, reliable, useful and usable information about their own performance. Managers and elected members need to be able to assess their services and identify authorities that seem to be doing better and which

Three tests of self-improvement

The future of public audit must include greater accuracy, both from the data supplied by organisations and the validation of auditors, says Steve Martin
Three tests of self-improvement

might therefore be able to offer useful tips on how to improve. However, as anyone who has been involved in benchmarking clubs knows full well, reliable comparative data doesn’t come easily or cheap.

The Local Government Association’s Inform project should be a very useful tool but it relies on councils to provide the data and undertake their own comparative analyses, which brings us to a second make or break issue - capacity.

Capacity

One of the by-products of top down assessment was the growth of the corporate centre. The emphasis on corporate capacity and the need to feed data-hungry inspection regimes meant that most councils appointed staff to oversee corporate policy and performance. In recent years some of these posts have been cut in response to budget constraints and the risk is that smaller councils may struggle to collect and make effective use of the information they will need to really take responsibility for their performance.

There are also questions about the capacity of the sector as a whole. The value of the LGA’s peer challenge process, for example, depends on the calibre of its peers. As the level of demand for their services rises (the LGA is offering all English councils a free peer challenge over the next three years) it may become increasingly difficult to assemble teams with the knowledge and skills that authorities want.

There is also the important issue of community capacity. A central tenet of the LGA’s Taking the Lead strategy is that accountability to local communities will drive further improvement. But this claim rests on a number of assumptions: that councils will collect the necessary performance data; that the public has the appetite, skills and understanding to be able to access and interpret these data; and that authorities will respond to concerns raised by communities. The chequered history of community engagement doesn’t offer much ground for optimism. However it might be argued that the new world of social media, nifty apps and web based transactions mean that we really are about to enter an era of truly participative, real time performance monitoring by citizens. Maybe, but this is a far cry from the cosy images conjured up by talk of “armchair auditors” poring over local authority spending, and it will call for considerable investment by councils in the skills needed to make good use of these new media.

Credibility

A third key test will be the credibility of self-improvement. Academic studies suggest that self-evaluation can help organizations to take ownership of their problems. However, the reality of local politics makes it difficult for controlling groups to acknowledge difficulties if this hands valuable ammunition to opposition parties. For this reason the public is likely to be wary of performance information provided by councils and this highlights the need for someone to check the data. In councils which take it seriously the scrutiny function could play a role in this, but there are many places where scrutiny remains unloved and underpowered and isn’t going to be up to the job. In any case many citizens wouldn’t regard scrutiny as independent enough to provide robust challenge.

So maybe this is where the future of public audit lies. In an era of self-improvement perhaps it is up to councils to decide how to measure performance and how to collect the data but it is the auditors’ job to validate the information they produce; that way, councils are in the driving seat, performance data reflect local priorities, but citizens and service users can have confidence that the information they are presented with offers an accurate picture of how well they are being served.

Professor Steve Martin is director, Centre for Local and Regional Government Research Cardiff Business Schools. He has led numerous studies of local government policy, including comparative analysis of approaches to performance improvement in England, Scotland and Wales.
Public audit - a client’s view

While public audit has achieved some success in highlighting agency failings, it has not gone far enough and an opportunity has been missed says Michael Bichard

As a client of public audit for too many decades in some of the more exposed public agencies, it would be all too easy to use this opportunity to settle a few scores.

I will not do that, however, because whatever the latest fad for minimal regulation, I do believe that high quality, proportionate public audit has a part to play in delivering high quality services and holding them to account. The question is whether it has fulfilled its potential during what may come to be seen as its golden age.

My conclusion would be that, in spite of some undoubted success and, at times, some inspired leadership, it has failed to take advantage of the opportunity.

**Failure to expose underlying causes**

On too many occasions the audit process, especially in government, has focused on incidents, events and specific failures but failed to expose the underlying causes. The failure of Whitehall to build a convincing management culture, in spite of all the rhetoric of the past thirty years, is ultimately the responsibility of Whitehall and successive prime ministers, who failed either to understand the issues or to give them sufficient priority.

But the failure of public audit to shine a light on the fundamental shortcomings has played its own part in this sad story. And if that seems harsh, let’s not forget that when the decision was belatedly taken to introduce departmental assessments into government the National Audit Office (NAO) was not invited to undertake these because it was not felt to have the necessary skills. That perhaps says it all.

**Failure to foster a climate of innovation**

Of course, one major criticism often laid at the door of public audit is that its trenchant criticisms have made organisations more defensive and less likely to be innovative or creative. But where criticism is justified it is the task of leaders to cope with it, learn from it and sustain a climate where innovation is valued. What, as a client, public audit seemed not to do often enough was to recognise examples of successful innovation and draw out the lessons for others to learn. It has been as if the sole priority has been to identify failure, which in turn has led to animosity between audit and its clients.

**Failure to encourage integration and preventative services**

When I look back on the failures of the public sector in the recent past I am struck by how public audit has again failed to draw these out.
Public audit - a client’s view

Most observers now accept that the failure of bureaucracies to work effectively together across organisational boundaries has cost us dear in terms of value and effective outcomes.

The Audit Commission has indeed focused on the issue of integrated community care but the NAO and the Commons public accounts committee (PAC) has continued to reinforce the departmental boundaries which are at the heart of these problems.

There have been few attempts to address themes rather than the responsibilities of single departments and rarely has the PAC called to account permanent secretaries from more than one department. Margaret Hodge, the committee’s new(ish) chair claims to want to put this right but there are, as yet, few signs of it happening. Other audit bodies have shown a similar reluctance to look beyond the narrow concerns of their parent departments.

If audit has failed to highlight adequately the basic failure of the public sector to cooperate across boundaries it has been equally culpable in its failure to draw attention to the importance of service design and - again with some honourable exceptions - the need to shift from responsive to preventative public services. These are the issues which have blighted our public sector and yet public audit has largely failed to cite them.

Failure to critically evaluate public policy

For much of my career I led agencies whose task it was to implement public policy and, as a mere labourer in the vineyard, I was often frustrated by the inability of audit to question, let alone criticise, the quality of the policy itself. It always seemed to me possible to find ways of auditing at least the process of policymaking which would not fall foul of undermining the democratic right of ministers to make political choices.

Frankly some departments are better at policy than others but too rarely have the reasons for this been explored. Local authorities who have too often been the victims of poor policy might feel this most keenly. They might also feel that more could have been done to build a culture of post legislative scrutiny in Parliament, something which audit might again have encouraged. In the event little, if any, post legislative scrutiny has taken place, which may explain why successive governments have been seduced into believing that legislation is the answer rather than a part of the problem.

A missed opportunity

I am, however, in danger of being too negative. After all, public audit has exposed glaring failures which through no fault of its own have remained unresolved. Perhaps it could have been better in following up reports but that is only part of the story. It has also introduced some accountability into public services where the unbridled power of the professional has worked against the interests of clients, patients, citizens and pupils. It has caused the spotlight to shine on some agencies, officials and local politicians who were clearly failing their citizens. But the question is whether we have seen a missed opportunity and my answer remains that we have.

Lord Michael Bichard has been a cross-bench peer since 2010 and is a former permanent secretary of the Departments for Education and Employment. He is a former director of the Institute for Government and has served as chief executive of the Benefits Agency, Gloucestershire county council and the London Borough of Brent

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