

AUDIT LIAISON GROUP

MEETING OF 31 OCTOBER 2006 HELD AT THE NATIONAL AUDIT OFFICE

Those attending:

Nick Macpherson	Permanent Secretary, HM Treasury}	Joint Chairmen
Sir John Bourn	Comptroller and Auditor General }	
John Coombe	External member	
Alex Allan	Permanent Secretary, DCA	
Sue Owen	Director General for Corporate Performance, DfID	
Tim Burr	Deputy Comptroller and Auditor General	
Mary Keegan	Managing Director, HM Treasury	
Gabrielle Cohen	Assistant Auditor General, NAO	
Paula Diggle	Treasury Officer of Accounts, HM Treasury	
Gordon Adam	Treasury Office of Accounts Team	
Robert Prideaux	NAO	

Introductions and Minutes of the Last Meeting

1. Sir John Bourn welcomed those present to the NAO for the meeting of the Group. Sue Owen reported that she was substituting for DfID Permanent Secretary, Suma Chakrabarti.
2. The minutes of the last meeting held on 27 January 2006 were agreed.

Moderated Feedback (ALG 07/06)

3. Gabrielle Cohen introduced a paper on the NAO's Moderated Feedback exercise which was based on a proposal from the Audit Liaison Group that the NAO should interview senior staff at departments and agencies as a method of gaining feedback on its work. The work had been contracted to RMS Robson Rhodes who had undertaken interviews at 19 organisations in the first year of a three year exercise which would take in 50 audited bodies in total.
4. The main message to emerge from the first year of the exercise was that the vast majority of clients viewed the NAO's service as sound and professional. RMS Robson Rhodes had assessed the interviewees' overall satisfaction with the NAO's performance as a 7.4 out of 10, which they described as "satisfactory" and a solid platform on which to build. There were also indications that the relationship between the NAO and its audit clients was improving. Generally, interviewees had valued NAO's financial audit work more highly than its value for money work, probably reflecting the critical nature of parliamentary scrutiny that followed the VFM process.

5. The NAO was currently acting to address a number of issues raised by the exercise. It was taking a more strategic view across its business, producing for the first time integrated client strategies to cover all aspects of its work and developing an enhanced role for client directors. It was also taking a “whole of government” perspective through greater internal knowledge sharing and the introduction of practice networks to disseminate key areas of NAO’s expertise more widely through advice and good practice guidance. These changes were designed to provide a better service to the NAO’s clients and to increase its impact across government.
6. In discussion, the following points were made:
 - The first year of moderated feedback had proved a valuable exercise and had resulted in a positive first report, which also indicated where there was room for improvement.
 - There were valuable suggestions in the paper for improving NAO’s service to the client. It was important, however, in the external audit context that the client did not become too reliant on the impact of the audit service and that the auditor resisted doing the client’s job for them.
 - It would be interesting to conduct some cross-analysis to the views of those who had experienced an audit service outside of government. The NAO would speak to RSM Robson Rhodes about the scope to include a question on this.
 - It was not surprising that clients should be more positive about financial audit than value for money work as the scrutiny of the Committee of Public Accounts made the latter an inherently more challenging experience for them.
 - The moderated feedback exercise complemented the NAO’s existing quality assurance arrangements, including the feedback provided by the client at the end of each audit. There was value in having the feedback moderated by a third party, and thereby anonymised, as this allowed for a franker discussion. There would be a need to take stock after the current three year exercise to see whether the likely benefits of extending the process were worth the cost and whether it could be improved.
7. Summing up, Sir John Bourn said that the NAO would take into account the points made by the Group and would report back after the second tranche of moderated feedback interviews had been completed in 2007.

Financial Reporting Issues (ALG 08/06)

8. Mary Keegan introduced the paper and thanked the NAO for their support in helping departments to achieve the target of laying their 2005-06 resource accounts before the parliamentary recess. Forty-two departments had achieved the target, and of the seven departments which had not, only four now remained outstanding. The speed of laying resource accounts had been steadily improving, and had not reduced the quality of accounting, but the government acknowledged there was a need to do better next year.
9. The Treasury were preparing cross-governmental guidance on International Financial Reporting Standards (IFRS). The Financial Reporting Advisory Board (FRAB) were keen to move to an accounting framework based on IFRS as soon as possible, but the Treasury had opted for a phased approach especially given the absence of an international accounting standard to cover Private Finance Initiative schemes.
10. In discussion the following points were made:
 - The NAO were generally pleased with the progress made towards laying resource accounts before the recess. The fact that the majority of financial audits had been delivered within budget was further evidence that the work to prepare the accounts had gone smoothly.
 - The Department for Constitutional Affairs had been one of the Departments to miss the target and had laid its accounts in the week Parliament returned from the recess. It expected to be in a position to lay pre-recess next year.
 - The NAO concurred with the Treasury that the introduction of an accounting standard in respect of the Private Finance Initiative would be a positive development which would provide a consistent and common framework for reporting. The Group noted, however, that evidence from the private sector showed that there could be different interpretations of how to apply accounting standards even where they existed.
11. Summing up, Sir John Bourn said that the Group welcomed the progress towards faster closing and the adoption of International Financial Reporting Standards and thanked the Treasury team for the update.

Corporate Services Benchmarking Project (ALG 09/06)

12. Tim Burr introduced a paper updating the Group on progress by the UK audit agencies in developing a set of value for money indicators that could be used by public service providers to help performance manage five corporate service functions: estates management, finance, human

resources, information and communication technology, and procurement.

13. The first phase of the project, commissioned from KPMG, had been to develop a series of such indicators for benchmarking these services within and across five sectors: central government, local government, health, police, and fire and rescue. The intention was to roll out these indicators across the whole public sector audit field. Questions for the Group included how the project could be developed to increase its usefulness, and whether it would make a positive contribution in the current climate of spending restraint.

14. In discussion the following points were made:

- The benchmarking project was valuable work and it was a positive move for the audit agencies to have started to bring together a suite of indicators to measure the efficiency of corporate services.
- The indicator sets proposed by KPMG, however, were over-complicated and too concerned with efficiency with insufficient coverage of effectiveness. They were also too long given the current climate of de-regulation in government. Developing a simpler and shorter set of indicators was critical to the project's success.
- Benchmarking only the back office functions of government departments showed limited ambition and it would be instructive to include benchmarks from the private sector where the profit motive could lead to different solutions and perhaps a more rigorous analysis of what level of service an organisation was prepared to pay for. Local government and international comparisons might also help to provide a wider and better set of benchmarks than that proposed.
- It was important to think through the uses to which the benchmarking data would be put. For example, the exercise should take care only to compare like organisations and the data should not be generated in such a way that it encouraged the formulation of "league tables".
- Before the benchmarks were launched more widely, they should be tested with a small group of organisations. Treasury would be keen to discuss with the audit agencies how the indicators might be refined and reduced before being rolled out across the public sector.

15. Summing up, Sir John Bourn thanked the Group for a useful discussion and said the NAO would work further with the Treasury, government departments and the other audit agencies to agree how the project could best be taken forward.

Corporate Governance (ALG 10/06)

16. Paula Diggle introduced an interim report on compliance with the new corporate governance reporting requirements and the quality of disclosures made in the 2006 reporting round. So far 11 Departments had been considered and of these only two had complied with every reporting requirement. There was also considerable diversity in the quality of reporting. Treasury were now enlarging the sample and considering how to proceed in order to encourage a greater degree of compliance without being too directive too soon.

17. In discussion, the following points were made:

- The NAO welcomed improvements in corporate governance that had already been brought about by the introduction of non-executive directors and a greater level of discussion of risks and their management.
- There was considerable overlap between the review and the departmental capability reviews which had considered corporate governance in some detail. It was important to bring together the messages from both reviews.
- In the private sector it had taken a few years before corporate governance reporting had settled down and good practice had been taken up widely. However, the reporting requirements had made organisations think hard about the adequacy of their corporate governance arrangements and had thereby led to change that would have been hard to envisage without them.
- It would be helpful if the Treasury and NAO could stimulate better corporate governance reporting by identifying and disseminating examples of good practice.

18. Summing up, Sir John Bourn said that the Group endorsed the Treasury's proposals to allow the reporting requirements some time to bed in and suggested that the Group should look again at their impact in a year's time.

Shorter VFM reports (ALG 11/06)

19. Tim Burr introduced a brief synopsis of the NAO's response to a request from the Committee of Public Accounts that value for money reports should be made shorter. Shorter reports had originally been suggested to the PAC Chairman by the previous Treasury Officer of Accounts as a way to enhance the accountability process.

20. The C&AG had agreed to the Committee's request, which should reduce the burden on Accounting Officers and assist them in preparing for PAC hearings and should also ensure that NAO's findings were more succinctly expressed and so less open to misinterpretation. The move to shorter reports was not intended to undermine the objective of

fair and balanced reporting to Parliament, but should lead to greater focus on the things that would inform parliamentary discussion. Other material that might be valuable to Departments and their delivery agents could be incorporated in separate documents which might be published or placed on the NAO's website, rather than being formally laid before Parliament.

21. In discussion, the following points were made:

- The Group welcomed the move to shorter VFM reports which they felt should have benefits to all involved in the parliamentary accountability process.
- It was suggested that in order to reduce reports to around 20 pages there may be a need in some cases for a tighter definition of the scope of VFM studies. And there would always be a need to make the context of the report clear. The NAO would aim for reports that did not exceed 20 pages, but recognised that not every topic would lend itself to this treatment.
- The Treasury should help to raise awareness amongst Departments of the NAO's move to a shorter reporting format and would reinforce this by sending a letter to Accounting Officers informing them of the change and seeking their co-operation.

22. Summing up, Sir John Bourn welcomed the Group's support for shorter VFM reports and the clear consensus that this should be a beneficial change to Departments as well as to Parliament.

Any other business

Freedom of Information

23. Gabrielle Cohen gave an oral update on how the NAO was responding to requests under the Freedom of Information Act for draft audit reports and the practical issues associated with releasing such documents. The NAO was unique among state audit institutions in that Freedom of Information legislation applied to its audit work as well as to its internal operation. Disclosure of audit working papers, correspondence and draft reports risks undermining the audit process and misleading the public should information be released, for example in an early draft of a report which proved to be inaccurate and had to be amended prior to publication of the final report.

24. However, the Act applied to the NAO and following legal advice and dialogue with the Information Commissioner, the NAO had decided in many cases that the law required the release of draft reports though some of the information contained in them, for example commercially confidential information, could be subject to exemption.

25. The risks from disclosure had materialised over the summer with the release of the report on the NHS National Programme for IT. Commentators had attempted to second guess audit judgements, for example, without the benefit of either the NAO's expertise or its objectivity. They had also represented changes between drafts as evidence of watering down the key findings rather than, as was the case, factual corrections. The confusion created had demonstrably not been in the public interest, and might be put to the Information Commissioner as a case study.
26. In discussion, the Group voiced serious concerns about the principle of disclosing draft audit reports, a process which they felt could undermine the basis of trust between Departments and their auditors. It contrasted with the normally privileged relationship between professional advisor and client. The potential damage to the audit process could therefore considerably outweigh any public benefit that came from disclosure of early drafts, and it would be appropriate to argue this case strongly with the Information Commissioner and to challenge his initial advice about the disclosure of audit papers, and in particular draft audit reports.
27. Summing up, Sir John Bourn thanked the Group for their input and said that the NAO would consult further with the Department for Constitutional Affairs on how this important issue might best be raised with the Information Commissioner.

NAO report on Resource Management

28. Mary Keegan said that she would welcome a discussion about how the Treasury might assist the NAO with its planned follow-up report on resource management by government departments, which would update the C&AG's earlier report published in 2003. She said that the Treasury would be keen to help the NAO, such as by setting up focus groups or interviews across government, and would therefore be interested to talk in more detail about the likely scope and timing of the work.

PAC Compendium Reports

29. Paula Diggle said that the Financial Secretary to the Treasury had very much liked the compendium reports recently produced by the PAC, and in particular the Committee's 63rd report of 2005/06 on Delivering High Quality Public Services for All, to which the government would be responding positively. Treasury Ministers in general welcomed this development of drawing together PAC findings into thematic reports.
30. In discussion, the Group considered other recent work by the NAO and PAC and, in particular, whether there was a risk of NAO being drawn into policy issues, such as in relation to the Private Finance Initiative where the NAO often reported on the deal struck before an initiative

had been implemented. The Group agreed that it was important for the NAO to work closely with Departments in such cases to scope the work appropriately, but that there should be no impediment to the NAO focusing its work on the outcome of individual deals without calling into question the merits of policy objectives.

Circulation of ALG Papers

31. The Group agreed that, as the meeting had involved the discussion of some quite lengthy reports, papers should be circulated to members at least a week in advance of future meetings.

National Audit Office