House of Commons

Public Accounts Commission

Oral evidence: National Audit Office Annual Report and Accounts 2022-23

Tuesday 11 July 2023

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Watch the meeting

Members present: Mr Richard Bacon (Chair); Jack Brereton; Clive Efford; Dame Meg Hillier; Mrs Sharon Hodgson.

Questions 1-57

Witnesses

I: Gareth Davies, Comptroller and Auditor General, National Audit Office, Dame Fiona Reynolds, Chair, National Audit Office, and Daniel Lambauer, Executive Director, Strategy and Resources, National Audit Office.

Examination of witnesses

Witnesses: Gareth Davies, Dame Fiona Reynolds and Daniel Lambauer.

Q1 **Chair:** Welcome to this meeting of the Public Accounts Commission on Tuesday 11 July 2023. We are joined by the Comptroller and Auditor General, Mr Gareth Davies; the chair of the National Audit Office, Dame Fiona Reynolds; and the executive director, strategy and resources, Mr Daniel Lambauer. You are all very welcome. We are under a tight timetable today, because we are expecting a whole series of votes and we would like to finish the Commission meeting beforehand, so hopefully we will go briskly.

Comptroller and Auditor General, could I start with you? The Crowe report highlighted that there is no element of contingency in the budget. You normally come to this Commission, ask for what you want and then, if you need more, for reasons that may or may not be beyond your control, you come back for a supplementary estimate. That has been the normal way. Crowe suggested that perhaps you might actually make up this difference by a direct recovery from the Departments' own resources, by charging a cash fee for unplanned overruns. What do you think of that approach?

Gareth Davies: It is obviously a straight read-across from normal practice in the private sector, so I can see why they have suggested that, because it is based on their experience elsewhere. We understand that it would require legislation, so that is the obvious practical hurdle, given the high bar set by Government for legislating for these things. In principle, it is a reasonable option.

Q2 **Chair:** Is there not a danger that, when Departments start paying the auditor, which is the reason this Commission was set up—to avoid that—we are going down a slippery slope?

Gareth Davies: Potentially. That is why it would not be my preferred option. It works perfectly well in quite a lot of our audits where we do charge a cash fee for our work and we would charge an additional fee for any overruns. Take the BBC, for example. It pays fees in addition to the amount that you grant the NAO for its Government work. In principle, we have demonstrated our ability to manage it without any impairment to our independence, but I think it is better if we are funded directly through the Commission by Parliament.

Q3 **Chair:** Your capital budget for 2022-23 includes an extra £3.3 million provision for entering into the new lease with the Newcastle office, which I had the pleasure of visiting a while ago, while you were still in the old Newcastle office. I think Dame Meg may have even been to the new one. How is that going? Is it proceeding on plan and on budget?

Gareth Davies: Yes, the project is complete and we moved in on 30 May, on target. The refit was completed within the budget that you have mentioned—so, a really good performance from the team that ran that project. The feedback from the staff using the office—Dame Meg was there last week—has been really excellent.

Q4 **Chair:** How many staff do you have there now?

Gareth Davies: We have 140 based there.

Q5 **Chair:** And the capacity?

Gareth Davies: They can all get in the office, if that is—

Q6 **Chair:** I mean, if you were to grow it, how much further could you go?

Gareth Davies: It is 10% bigger than our previous office, so there is a little bit of headroom for us to grow—roughly 10% of the headcount up there. Of course, nowadays, given how flexibly we are working, it could potentially be a bit more than that.

Q7 **Chair:** Professional services costs increased by £1.3 million, which was around a 9% increase. Is that just inflation, or have you bought more professional services?

Gareth Davies: The price has gone up—that is a big chunk of that increase. We retendered our outsourced audit contracts with the firms, and that was the first year of those new contracts. There were fairly significant price increases, of 9% or 10%, which is lower than they are charging their commercial clients, but obviously still significant. But there is also a volume increase in there. Under our quality improvement plan, which we also talk about in the annual report, we are spending more on specialist advice—things like actuarial advice and valuation advice—and that is increasingly common on our audits. So there is an element of volume as well as price increase.

Q8 **Chair:** Is there no case for having an internal resource for things like actuarial skill?

Gareth Davies: Up to now, there has not been. Every time we have looked at it, we have concluded that the work is too sporadic and the volume not big enough to justify, say, our own in-house actuary or in-house valuer. That calculation is changing, though. As I say, if the work itself is becoming higher volume, and clearly the price is going up, that business case is now looking more marginal. So we are looking in detail at all of those areas where we do spend significant amounts on commercial advice, in case the business case has now flipped and there is a case for providing it in-house.

Q9 **Chair:** One of the items, marked "other administration costs", has more than doubled—from £410,000 to £849,000. Can you explain what that is?

Gareth Davies: I will bring Daniel in on that one.

Daniel Lambauer: One part is actually a bit of an anomaly from last year. We have Turkish Airlines as one of our tenants, and three years ago we gave them a rental holiday, so to speak, because as you mention, in the pandemic all the airlines were a bit under pressure. We did say that they should pay it back if they could; we made a provision to the accounts for that. They did pay us back, so last year we counted it back. So that explains about £200,000 of that figure. The other figure—main figure here—is an amount of corporate subscriptions, where we have access to industry data, knowledge and expertise, in line with our knowledge objective as well as our quality objective. That cost has gone up, where we need to access the latest accounting data, all the client corporate finance data, also technological data from subscription services or analysis, consultancies—something like that.

Q10 **Chair:** Mr Davies, computers and other equipment saw additions to the balance sheet of £3 million. That is a lot of laptops. Can you explain how you ensured value for money?

Gareth Davies: It is essentially all of our laptops. Rather than have a staggered replacement programme, we buy in bulk once every few years. I was a bit surprised: that was not the policy I was used to in other organisations, so I did challenge the value for money of that approach, but yes, there is a really good demonstration that we get better prices that way, and it is easier to support over the lifetime of the laptops as well, because every laptop is of the same generation, with the same configuration. So it is more efficient for our team to keep them working.

Q11 **Chair:** Are there lessons for Government—I was about to say the rest of Government, but you are not part of Government—from that approach?

Gareth Davies: Possibly. It couldn't be a big bit of Government because even at our scale, that is a large order, and if you happen to be ordering when there is heavy demand on the suppliers, then you can actually run out of market capacity. So I doubt if it is a practical proposition for the big Government Departments, but maybe for small bodies like ours it is useful.

Chair: Presumably, you can get market intel about what demand is like overall before you place your order, and whether to do it at a particular time or not. Right—thank you.

Q12 **Clive Efford:** In your risk report you identify information security as a risk that is approaching an immediate concern. What specifically is your concern?

Gareth Davies: The external environment is the concern there, because although, as you would expect, we spend a lot of time and effort controlling this risk, the external risk has continued to increase—especially the hostile state actor risk, after the invasion of Ukraine. All public bodies, all organisations, have strengthened their cyber-security stance following that. All of the reports we get on attacks on our systems and so on are demonstrating a really high level of external risk. So, even though we are continuing to invest in strengthening our systems—we are in a good place, because all of our IT services are now in the cloud, and it is much easier to manage our security stance in that way—you can never take your eye off that ball, never be sure that you are not going to be the victim of a phishing attack, for example. It just takes one human error in the organisation to open the door to that kind of attack.

So we spend a lot of time on staff awareness and we spend a lot of time on our IT defences, but it is a high risk. Having it here, on our risk register, keeps us alert, makes us continually review what is going on and learning from the rest of Government. Obviously we have links with the National Cyber Security Centre and so on, who we take regular advice from.

Q13 **Clive Efford:** So rather than its being a specific risk where you have experienced something or identified the possibility of an attack, it is actually something you have identified as a distinct possibility—

Gareth Davies: High vigilance.

Clive Efford: —that you need to be vigilant about.

Gareth Davies: Yes. We had no adverse incidents in the year—actually we have had none for some time—but we are far from complacent about that, because obviously we see what happens to lots of the bodies that we audit. So yes, it is a kind of state of vigilance and we know we need to continually improve our defences; that is really what is behind that.

Q14 **Clive Efford:** One area of high risk is contracted-out audits. You exceeded your planned budget in this area, due to rising costs. We spoke in a previous evidence session about the NAO's model of contracting out some audits, in the context of increasing fees. Has your thinking on this progressed?

Gareth Davies: Yes, it has. Dame Fiona might want to add to this because we had a board session on this in June. As we said at the last session, because of the changing cost structure from using the firms, we are doing a full value-for-money review of what our approach to outsourcing should be in the future once these framework contracts come to an end. That review is underway, and we had an interesting discussion at the last board meeting.

Dame Fiona Reynolds: Yes, we did. I think it is fair to say that we see it as an opportunity to look strategically at the sorts of skills and attributes that we will need in the future. We have tended to contract out for two reasons: one is volume, the other is where there are specialist skills we do not have in house. We have seen this as an opportunity to anticipate future needs, and the board was certainly very sympathetic to not a dramatic change, but a phasing in of more in-house capability, which we think will strengthen us for the long term.

On the wider question of the risks, I would simply add that I think most of the high risks here do represent high vigilance, rather than a feeling of great vulnerability. All these risks represent us being on top alert for issues that may arise, but in each case, we have very good mitigation and very good control. But we know that all of them represent issues that are very present and therefore we need to keep alert.

Q15 **Clive Efford:** Is there any concern about the risk to the quality of audits when you outsource them?

Gareth Davies: Both, actually—both outsourced and our own. Again, that is another high vigilance area. Obviously, we have an annual session with the Commission on quality, which is coming up in the autumn. Alongside people retention and engagement, quality—both of financial audit and value for money—is the thing I spend the most time and energy on, so that is a good measure of where it is on our risk register. As I have explained before, that is partly because of what is happening in the audit profession generally. Standards are going up very fast driven by the regulator and in response to problems, which you know about, in the commercial world. We are covered by that as well, so we are having to work very hard to keep up with improving standards in the rest of the profession.

On value for money, this is our raison d'être as far as Parliament is concerned. It absolutely relies on the accuracy and thoroughness of our value-for-money work. Again, that is another area where it remains only as good as it is because we spend a lot of time improving our methodologies and looking at our training on how we develop our staff around it, and that work continues. In both cases, we focus a lot on the quality of our work.

Q16 **Clive Efford:** Talking about value for money, the Crowe value-for-money report recommended that you periodically review the use of temporary staff. How reliant are you on temporary staff to complete your audits, and how do you intend to act on this recommendation?

Gareth Davies: We try to minimise that, but it is an essential part of our model because, as you know, all our audits—bar a very tiny number—have the same year end. That is unlike any firm. A firm will deliberately seek clients with a range of year ends to make sure the work is spread through the year. We cannot do that. 99% of our clients have a 31 March year end. That produces a peak in the work in the summer, which is unavoidable. We cannot staff up to that with permanent staff because we would not have enough work to keep everybody occupied throughout the rest of the year.

There will permanently be an element of temporary capacity in our business model. I think that will reduce as we make more use of data analytics and controls assurance, because we would be able to do more of that work throughout the year, but it will always be there. Our job is to make sure that it is no bigger than it needs to be. We have really good links with a cohort of temporary audit staff who come back year after year, so they may be temporary in the year, but we know them well and they know our methodology well. That minimises the risk to quality, and we get some excellent work from those people. That is actually a valued part of our resource, but it needs to be no more than it has to be.

Q17 **Clive Efford:** Finally from me, the delivery of your audit transformation programme is close to the critical threshold for risk. Is the ATP on track?

Dame Fiona Reynolds: Again—I think I say this every time to you—this is the board's watching alert, and we are very pleased with progress so far. Phase 1 has been implemented and the training has been taking place—particularly the new risk model—and we have had tremendously positive feedback across the staff involved. The next phase is actively being prepared now, and we expect to go live in the autumn. Again, high alert, high vigilance, a lot of work going on, but at this point we feel that this is a project that is progressing well. We are determined that it will continue to be so.

Gareth Davies: At the moment, it looks like we are on budget and on time for an IT solution developed in-house, which is not a sentence that we write very often. I am far from complacent, because there is still a long way to go, but we are on track and it has been an excellent collaborative effort between us and the external supplier.

Q18 **Chair:** I will bring in Jack Brereton in a moment, but before we completely leave this subject, you mentioned quality and the needs of Parliament. Quality is of course an important part of it, but so is timeliness, and we have had lots of delays for understandable reasons—because of the pandemic. Sometimes, I fear that some pressures placed on you by, for example, the Financial Reporting Council might possibly be unreasonable or unfair, notwithstanding the fact that we are looking at a new environment where high quality is a norm. Will you say a little about where you think that balance should sit, and whether the FRC is doing you justice?

Gareth Davies: Our audits are improving quickly, significantly due to FRC pressure. We absolutely need to recognise that it is appropriate to put us under the same scrutiny as the big firms for the quality of our work, and it genuinely helps us to improve. That is the big picture.

Yes, there is tension between getting ever more assurance on tricky areas of the accounts and completing the work in a way that is useful and timely for Parliament, but that is a risk—it is almost the definition, essentially, of the professional task facing our financial audit colleagues. They do a really good job of it.

Before coming here today, I certified the accounts for HMRC for the year to the end of March. That is an enormous account, with a lot of complexity, plenty of audit risk and a high level of IT audit engagement—that is one of the most modern audits we do at the moment, along with DWP—and it has been landed in mid-July. That is a real achievement by that team. I am really proud of the quality of that work we do.

The FRC's inspection shows that we do not always get things right to that level, but we always respond to that. This year's reviews are showing that we have responded well to the recommendations last year on financial instruments, for example. It is a powerful improvement tool.

I am in a fortunate position, because I do not have the commercial risks of the firms. I can make a judgment about the balance of assurance and timeliness, so if we have 99% of the assurance required and the delay would take us well into the autumn, at least that is a professional judgment that I can take. I sometimes take the regulatory feedback that comes with it. I feel well equipped with the support of Parliament to make those judgments, but we are absolutely focused on making sure that our audits stand up to the best in the private sector.

Q19 **Chair:** You mentioned the DWP. Does it now have an unqualified set of accounts?

Gareth Davies: Not on regularity; it does on true and fair. The figures are a fair reflection of what has been spent.

Q20 **Chair:** It used to be true that DWP had not had a set of clean accounts since 1988. Has that changed?

Gareth Davies: That is still true. This was the 35th consecutive year on regularity. What that means is that the accounts are accurate, but in those figures is a material level of fraud and error. That is why they get qualified every year at the moment.

Inherent in the system of benefits is a certain level of fraud. This was derailed a bit by covid, but we are now back on the case with the Department. We are working to a reasonable minimum level of fraud and error. Clearly, none is acceptable, but accepting that there will always be some level of it, what is a target that the Department can aspire to that would allow us to lift the qualification? We are working with them on that, but we are some way off.

It is far too high at the moment to consider lifting the qualification, but it is right, rather than treating it as a hopeless task, to agree some targets and work out how the controls could be improved to get there.

Q21 **Jack Brereton:** Just on your first point, I think in the Department for Work and Pensions it is something like 30% in terms of fraud. Is that not seriously concerning? By lifting those targets we are rewarding the poor performance we are seeing in the Department.

Gareth Davies: First, I am not sure I do recognise 30%. Maybe I can let you know what the figure is. I do not think it is as high as that, but it is too high. I think everyone would agree on that. We have not done anything to take the pressure off the Department to minimise that level. This process of talking to them about it and setting targets for reduction is going to drive improvements faster than if we did not engage in that way with them. We are obviously proceeding very cautiously, but our aim with the audit work we are doing is to encourage the Department to bear down on the levels of fraud and error faster than they have been.

Q22 **Jack Brereton:** In terms of the financial impact of the NAO, you claim that there is £7 for every £1 spent, but that is actually lower than your £10 target, and it is quite a bit lower than some of the figures you have achieved in the last three years. We had a high of £16, which is far more significant than £7. Why is this?

Gareth Davies: There are a few reasons. One is that it is lumpy. There can be some very significant and individual items that drop out. Some of these are one-offs, but most of them run over three to five years—that sort of period. If a very large one drops out, it has a significant impact on the total straight away. That has certainly happened in that time. The other big reason is the pandemic.

What we would expect to see coming through now would be savings that our work had identified two or three years ago. That is the way the cycle works. Two or three years ago, our programme had to be upended to accommodate work on bounce back loans and PPE procurement. We did 37 value-for-money Reports for PAC on different elements of the pandemic response, and they were not geared up for annual savings of this kind. It was much more about how the money was being spent, how the risks were being managed and how they were clawing back lost money and so on, so those have not been as fruitful as our normal diet of value-for-money work. We are now refocusing on this element of our work, but it is always a balance. This is not the only indicator of our impacts and effectiveness.

As a quick aside, the Public Accounts Committee session yesterday afternoon took evidence from the director general at the Home Office in charge of the Passport Office. They were able to explain how the backlog they had built up in the pandemic had now been successfully cleared, and they are delivering passports now at 99-point-something per cent within their target. After a Report that we and PAC did quickly on those problems emerging from the pandemic, they acknowledged that it was useful to them in making that improvement. That is an example of a non-financial impact that has had a real effect on services to the public. But this is an important part of our impacts. The projects we are selecting for coverage in our programme since the pandemic has ended should return us to delivering the kind of levels you were talking about from three years ago.

Q23 **Jack Brereton:** This has been a declining trend over the last four years. Are you confident that this will be the low point and that we are now going back towards target in the next year or so?

Gareth Davies: I am not quite confident enough to say that, but we are doing the right things to restore this to the target level. Whether that will be next year or the year after, I cannot be certain at the moment.

Dame Fiona Reynolds: I would add that we are thinking about this issue at board level in terms of how we define impact overall.

Q24 **Jack Brereton:** I can see that it is one of your main priorities. You say that there could hardly be a more important time than now to be watching over the way public money is spent.

Dame Fiona Reynolds: Indeed. I passionately believe that. The board passionately believes that. One of the things we are keen to do is try to identify other forms of impact alongside financial impact. We absolutely recognise that financial impact is one of the key indicators of our success, but we are really keen to pin down how to capture some of the other impacts and improve performance, delivery and have more efficient Government. All those things I have talked about in the past, and we do work on them. As our strategy review work continues, which we are now engaged with, I hope you will see more of that coming through—a clearer identification.

Q25 **Jack Brereton:** Is the board disappointed with the figures we have seen?

Dame Fiona Reynolds: We discussed it in exactly the way that the C&AG has just described to you. There was a very clear reason. We had deliberately focused on covid work and needed to do that. I would hope that Dame Meg would have seen the quality of that work coming through and making a real difference in its own terms. We recognise why it was the case, and we do value financial impact. I am sure it will increase. We are very keen to emphasise that there are other forms of impact that we also value strongly.

Gareth Davies: Can I add to the answer I gave earlier? The commodity that the NAO is here to increase is value for money, and efficiency of course, but it is also trust in how Government uses public money. The accountability element of our work is just as important as the improvement element.

Q26 **Jack Brereton:** But value for money is pretty fundamental.

Gareth Davies: Of course it is, but so is trust. My point is that two thirds of our expenditure and activity is on financial audit work, which does not generate the savings you talk about, but it does generate trust in the accounts being presented to Parliament and the public. That is a really important part of the commodity.

If you look at the survey of parliamentarians that is included in this report, it is at its highest level and significantly higher than three or four years ago. One of the questions that has reached its highest level is that the NAO's work leads to improvement. That is a really important measure of our impact overall. No ducking the fact that that indicator you are mentioning has gone down from three years ago and needs to go back up again—and will, I think. However, is the NAO delivering its mission to Parliament and the public? Absolutely, it is.

Q27 **Jack Brereton:** Let us look at some of your other targets. Of the 19 indicators of performance that you have set out in figure 4 of your annual report, you have achieved and are on target for fewer than half of those.

Gareth Davies: Eight, yes.

Q28 **Jack Brereton:** Why is that?

Gareth Davies: Because our philosophy with those is that they are there to drive improvement. I audit lots of annual reports and accounts, some of which are—put it this way, you can see that the targets have been designed to be hit. We use these to stretch our performance and to deliver improvement. Some go up and down, like the one that we have just been talking about, but I would much rather have a demanding set of targets here, such as our diversity targets, for example, and our timeliness targets, which push us to improve what we are doing, and then come here and explain why we are hitting some but not all. That is the right way around. I would be loth to come with a predictable set that I knew I could hit every year. I do not think that would drive the improvement we need.

Dame Fiona Reynolds: I would certainly agree that the board, too, is passionately committed to an ambitious organisation. Indeed, we describe our ambitions as to be exemplary across the board and that is a very clear statement that, in a sense, is never going to be achieved in some ways. We set targets of 100% that are deliberately there to stretch the organisation. They will probably always fall short, but hopefully less short by dint of our efforts.

In my own experience, I have always set targets that are stretching and the effort of trying to achieve them means you achieve more than if you set a safe target, hit it and therefore do not learn as much about the process. The board is very comfortable with the targets that we have and encourages and challenges the staff on each and every one. Yet that does not mean we do not want there to be stretch in the ambition.

Q29 **Jack Brereton:** As you suggest, with a lot of these targets, particularly where we are seeing these targets not being achieved around audit quality, the target is 100% and in some of those cases, 56% or 65% has been achieved. Do you not think that the targets are a little bit ambitious?

Gareth Davies: Yes, they are ambitious. Clearly, if we were berating the staff every time there was a shortfall on one of these targets, it would be a pretty demotivating process. That is not what we do. The tone that we have tried to describe to you in these answers is exactly how we talk about it in the organisation. The NAO is a pretty critical organisation for the country, and it needs to be an exemplar in the way that Dame Fiona said. People feel that. They feel this is a really important place to work. We want to do the best possible job for Parliament and for the public and so, I think people do share this level of ambition.

The other important thing to say is that 2022-23 was a tough year for all organisations—not just Government, but organisations in all other sectors. This recovery from the pandemic, which characterised 2022-23, was really tough on staff. We are recording an increase in our sickness levels, which is a very common picture around the economy. We have seen a dip in staff engagement scores, which partly related to the exhaustion factor of coming out of two and a half years of a relentlessly high throughput of—

Q30 **Jack Brereton:** Having targets that are not achievable for staff is also creating unnecessary pressure in some cases. Would it not be better to have targets that they can actually achieve and work towards?

Gareth Davies: A really good example of why that is not simple is the audit quality target. If you do an audit, the only reasonable target is that

that audit meets quality standards—the professional standards that then get inspected. Only a small sample get inspected each year, so our target has to be 100%, because you cannot do an audit and get 83% of that audit passing or not passing; it is a binary target. It is a reasonable target to have every one of our audit team's audits meet this quality standard. We know that it is going to be very unlikely that we achieve that as an organisation in a year, but it is not possible to translate that to an individual team target. That is a good example of why that is tricky.

Q31 **Jack Brereton:** So you are confident in getting these back to an acceptable level.

Gareth Davies: Everything we are doing is geared up to doing that on all these targets, so yes.

Dame Fiona Reynolds: But we might not hit every target every year, for the reason that I set out. We are comfortable with that, so long as there is clear evidence that we are making progress or a really clear explanation. For example, on the diversity target, we have been very clear that our recruitment is going really well, but there is a challenge around retention at a certain point in the process. The insight that we gain from having ambitious targets is really helping us to drive improvement.

Q32 **Jack Brereton:** I would hope that we would move towards hitting a majority, rather than a minority, of the targets.

Dame Fiona Reynolds: Yes, indeed—certainly that.

Q33 **Chair:** I want to bring in Sharon Hodgson in a moment, but let us pursue this for a second, because there are 19 indicators in your report, in figure 4, but they are actually brigaded into six sections, including on effective accountability, on leading to better outcomes and on independent insight. There is one on people, one on technology and one on being an exemplar. Is that structure—what you call a performance measurement framework—pretty stable now? That is what you are going to stick with.

Gareth Davies: The first three of those are our external strategic objectives, so that is what we are aspiring to deliver for Parliament and the public. The second three are the internal enablers that allow us to achieve those. That is where those six come from—they are from our five-year strategy, so they have been stable all the way through the five-year period.

Q34 **Chair:** In terms of comparing like with like in the future, are you expecting to stick with these?

Gareth Davies: We are for the next two years or so, up to the end of 2024-25—that is the end of our five-year strategy. In the year running up to that, we will be refreshing it. We could well have the same or similar objectives. I would be surprised if there was not some adjustment to reflect what we think the challenges will be for the next five years, but, fundamentally, it is very hard to imagine that these are not going to be important to the NAO for much longer than that, so we should be able to track performance over a long period.

Q35 **Mrs Hodgson:** My questions are moving on to the staff survey results, workload and sickness absence. You mentioned sickness absence in one of your answers. The NAO's overall staff engagement score in your survey was 6.5 out of 10, falling from 6.9 the year before and 7.3 the year before that. Your target is currently 7.4, so it seems to be a concerning downward trend. What are you doing to increase staff engagement?

Gareth Davies: As I say, 2022-23 was a tough year for everybody, including our teams, and we experienced a very significant level of turnover midway through the year. The firms were recruiting more aggressively than usual and inflation was taking off, so people were very receptive to increased pay offers from other employers, quite reasonably. We have had concerted action on that itself.

The Commission will remember that we explained to you that we were, very unusually, increasing pay for staff below manager level by 1% midway through the year last year. That was a direct response to the turnover challenge. We have a pay review, which is working its way through at the moment, designed to be a more structural solution to that, to make sure that we are competitive in the employment market for qualified auditors. That is working its way through. That is a key factor, and turnover has stabilised since we made that in-year pay increase. It is now at about the target level that we want.

The reason that is so important is around the staff survey scores. It is the same in any organisation: if there is a higher level of turnover than you had budgeted for, the pressure falls on the remaining staff, and workload pressure is felt even more keenly than usual. That is why that has been so important for us to get under control. At the moment, we are not carrying any unfilled vacancies; we are able to replace anybody who leaves within a reasonable space of time. Another really positive indicator is that we filled the vacancies for our graduate recruitment round for this September coming up several weeks ago, which is much earlier than not just last year but in the years before that—and with really high-quality candidates. All the indicators are that the resource pressure that was felt by the teams very keenly in the middle of last year has improved. If any of them are listening to this, they will beg to differ right now because we are in the last week and a half of the pre-recess completion of audits, so it is a very busy time at the organisation at the moment.

The fact is that we are better resourced than we have ever been. We are catching up. Another source of the workload pressure has been the delays to accounts. We pulled back a significant amount last year and another big chunk this year. We will have over 60% of our audits completed by the summer recess this year, with more of the main Departments in that figure as well. We are gradually getting back to the pre-pandemic picture of audit timeliness. That helps because the process of recovering the ground adds workload into that, because you are not just doing the previous year's work; you are catching up to bring it forward. Again, that is another thing that will ease the pressure on teams for next year. It is definitely a tough year, but we think that we understand the reasons for that.

As well as the action that I was talking about on pay, we are also working on health and wellbeing, given the obvious concern around mental health, which is the bit that we are most focused on in the staff absence figures. Not only do we need to avoid that wherever possible, clearly those cases tend to be longer cases than short-term absence due to physical ill health. It is really important that we crack that side of it, so the health and wellbeing plan is being worked up to tackle that side of it.

Dame Fiona Reynolds: Obviously the board looks at these figures with great care as well. We have taken a further step of recruiting a new chief people officer, Catherine Hope-MacLellan, who has come from outside the organisation and has a lot of experience in what is in the jargon called the staff engagement strategy and the employee value proposition. All these are slightly jargon words, but what they mean is recognising that we will never pay commercial salaries; we cannot compete with the private sector on money, but we want to ensure that we are providing a great place to work, where people are recognised and valued, and the teams and the working environment are as positive as they can be. She has come in with some really good ideas and is going to really focus on this as she goes forward. Dame Meg went to the Newcastle office last week, and the board was there in mid-June. The beaming faces of the staff and that feeling of being valued through the provision of really high-quality accommodation was a really good signal that those things matter to people.

Q36 **Mrs Hodgson:** Absolutely. You have pre-empted one of my questions, which was on workload. I was going to press you on that, but I feel that I have the answers that I was looking for. You have touched on my next question, too, on mental health and wellbeing. The environment is very important for staff mental health and wellbeing. We noticed that mental health was the most common reason for sickness absence at the NAO. It was resulting in an average of 1.7 days off work. Does that speak to anything in particular about the culture, or is it the workload that they have been under?

Gareth Davies: Obviously we have a really important job to do, so that sense of responsibility echoes through the organisation. We recognise that there is a peak in our workload, as I described before, and for a short part of the year we expect teams to work really hard, but that has been an element of any audit organisation I have been part of before. It isn't for everybody, of course. We have to be realistic, and we try to communicate what the job is like before we recruit people so they know what they are getting into. It is absolutely not in our interest to give anybody an unreasonable workload.

Another thing we are very conscious of and are trying to watch very carefully is that the cohorts of graduates and school leavers we have recruited since the pandemic have definitely been affected by the experience of being at university or school during the lockdown periods. That has had a direct impact on the way they approach the job. Obviously, I am generalising—there are plenty of exceptions—but that is an economy-wide phenomenon. We are trying to understand what additional support and training is useful for a group that has had a very distorted experience, compared with those of us who were not affected in that way.

Q37 **Mrs Hodgson:** You're right. That is an important point as well. My last couple of questions are about diversity and inclusion, which leads on nicely from the point you were just making. Why do you think you have struggled to retain ethnic minority staff post qualification? What are you doing about that?

Gareth Davies: The first thing I would say is that, overall, we are making really significant progress on diversity. As Dame Fiona said earlier, our recruitment is going really well on gender, ethnicity and disability, so we can genuinely claim to be a more diverse and inclusive employer than we were four years ago—very significantly in some areas.

On ethnicity, which is the example you picked, recruitment at graduate level is going really well. We get a very diverse graduate intake every year, and that is proving to be not a flash in the pan but a reliable process. However, as you say, more of our colleagues from ethnic minority backgrounds than we would like are getting other jobs on qualification—thirty-something per cent., whereas our target is 20%, so that is the gap we are focusing on.

Clearly, some of it is a case of, if you look at the organisation, do you see people like you? Can you envisage yourself in the senior roles? We do okay on that, but not as well as we need to, so this is also about senior recruitment. The only answer is to make sure that people have a fair opportunity for promotion if they are internal candidates, and that our external recruitment is fair.

Q38 **Mrs Hodgson:** Is it pay? Do they leave for better pay?

Gareth Davies: In some cases, but of course that is regardless of ethnicity. I don't think we have any evidence that that is particularly focused on one ethnic group or another. I think it is also about, "Is this the organisation for me? Is this somewhere I can make my career?" A practical thing we are doing is a mentoring programme, so that aspiring senior people—people who want to get to director level and above in the organisation—are being actively mentored in some of the inbuilt ways of working in the organisation that you have if you are from particular backgrounds. We don't just rely on luck; we help people to develop a full range of skills. That is in its early stages, but it is promising.

Q39 **Mrs Hodgson:** You mentioned that you look at this across gender, disability and so on, but you seem to have been unable to secure a gender balance in your trainee intakes. Is this an industry-wide issue or an NAO-specific issue?

Gareth Davies: Yes, it is industry-wide. I am a bit impatient about this, to be honest, because it is an industry-wide thing, but I think we shouldn't be affected by it. You will see in the same figures that we have now reached 50% of our manager grade being female; it was only 37% when I started four years ago, so we have made really good progress there.

This is a great job for anybody. We can give flexibility to people of any background and any gender who want to work with us, and we can point to a 50:50 gender split in our top management team and in our board. So on that point about looking at the organisation, absolutely anybody can see that this is a great job for female recruits. We are therefore slightly mystified about why we don't get applications. It is about the volume of applicants, because once people apply, they have an equal chance of getting through to being appointed, regardless of gender.

It is down to us to market ourselves. What is it that is different about the NAO? Market that more effectively. Use social media to showcase what we are doing at all levels of the organisation and how well people have done in their career by joining us. Yes, we have got more to do on that front.

Q40 **Dame Meg Hillier:** You touched on some of these issues in response to Mrs Hodgson's questions, but we discussed with you last year the extra pay you were putting in to try to hold on to people. How is that landing? You have talked about the lower turnover. Is that extra pay what is making the difference?

Gareth Davies: The interim pay award in the middle of last year was helpful, I think. Certainly, the crisis eased at that point.

Q41 **Dame Meg Hillier:** Was the 1% increase for the lower grades?

Gareth Davies: For the lower grades, yes. Then we had a 4% increase at the start of April for all staff. The bigger and more structural reform, introducing a new grade for newly qualified staff, which is all about retention and progression, is part of our pay review. We are still finalising the negotiation of that with the union—actually, this week is a crunch week for that, and we hope to get that resolved this week, because we think that is probably the single biggest step we can make towards retention and progression in the way that we have been describing. That is still to be implemented, but nearly there.

Q42 **Dame Meg Hillier:** We have talked about the turnover rate for the trainees. That was partly discussed in relation to money; I don't know if there is anything you want to add to that. But the senior analyst turnover rate is also above target, at 16.5%. What are you trying to do about that?

Gareth Davies: Again, we have increased the range for that. The reforms that I was describing just now include range increases for that grade as well. This is a good package. Once we bring it in, I think that makes us competitive in all these areas.

Q43 **Dame Meg Hillier:** Is this the grade that came between audit principal and audit manager? I lose track of your grades.

Gareth Davies: The senior analyst one is on the VFM side; on the audit side, essentially, we have split what was a very long post-qualification grade, so there is a senior auditor on qualification, but audit manager progression sooner than before. Managing some of our lower-risk clients and so on is for that new grade, and then senior audit manager for the ones who manage our largest and most complex clients.

Q44 **Dame Meg Hillier:** The turnover for that audit manager grade has gone up quite dramatically.

Gareth Davies: Yes.

Q45 **Dame Meg Hillier:** Is it now because it's comparable with the private sector, so people can jump across more easily?

Gareth Davies: With managers, I think that was a case of pent-up demand from the pandemic. We lost very few managers in the two years prior to the year we are talking about. Quite a lot of people who were ready to move on waited until the end of the pandemic and then made their move.

Q46 **Dame Meg Hillier:** Have they told you anything in exit interviews? Do you do exit interviews with people leaving?

Gareth Davies: Yes.

Q47 **Dame Meg Hillier:** What have they told you?

Gareth Davies: "Time to move on" was the biggest single group there. Manager to director felt like quite a big step before we introduced this stepped grade, so I think quite a lot of people thought it was going to take too long for there to be enough vacancies for them to be a director. Hopefully, what we are doing with the grades helps on that. But also, as I say, we've seen turnover on the manager side come back down to a more normal level.

Q48 **Dame Meg Hillier:** Do you have an alumni network?

Gareth Davies: We do, yes. It's not as active as I would like it to be.

Q49 **Dame Meg Hillier:** Not people who are retired; people who are still active.

Gareth Davies: People who used to work at the NAO and have moved on to other jobs. It is a lot easier to run those networks now, in the age of LinkedIn and so on—we have an alumni group on LinkedIn that has hundreds of members—and we offer special workshops and events for alumni.

Q50 **Dame Meg Hillier:** Does that help to keep people? I know it's rather odd to compare, but when we looked at RAF pilot recruitment, it turned out that when they left because they wanted regular hours and to work for an airline, when they were just Facebooked and asked, "Would you like to come back to the RAF?", quite a lot of them did. Just in terms of keeping the skillsets that you have developed, even if people have gone out and got useful experience externally—

Gareth Davies: We have had some successful re-recruitment of people who left us to go to, typically, the firms; sometimes that happens quite quickly—within a year. With others, it has been substantially later than that—after they have developed their career and can come back at a higher level. We have been really keen to encourage that—the sense that when you leave the NAO, it isn't necessarily for good; there are opportunities to come back.

Q51 **Dame Meg Hillier:** I have to say, Chair, that when I was up in Newcastle last week, the feeling and culture among the interns, the school recruits and the graduate recruits was very strongly like the one that I know from having had the privilege over the years of dealing with senior directors a couple of times every week. The culture beds in very quickly. I don't know what you are doing, but that seems to be working. I don't think they were hand-picked just to meet me.

Dame Fiona Reynolds: I met the interns, too. The Newcastle ones were online and the London ones were in the office. It was really interesting. They were quite vocal—actually, the ones who were vocal were very vocal—

Dame Meg Hillier: They had only to think of the previous week's PAC—don't you worry!

Dame Fiona Reynolds: They were all really interesting. They saw the NAO as an organisation with a cause, as opposed to a private sector organisation that is there to make a profit. I thought that was really important because we are an organisation with a cause. That is often a really big differentiator in terms of loyalty and commitment. I think we have the opportunity to really build on those values.

Q52 **Dame Meg Hillier:** There was one very talented young woman who said that she had worked in a shop where she dealt with shoplifters, so she had to investigate and liked doing spreadsheets and tracking money. She didn't know it, but someone said to her, "I think you need to be at the National Audit Office." This is perhaps an unusual route in, but the detective work and the numbers are appropriate.

There is one really quite important issue in the accounts. You had a £72,000 exit package for somebody. What was that about? You can't tell us about the individual—

Gareth Davies: No, I am not going to go into individual details—

Dame Meg Hillier: But what was it for?

Gareth Davies: Well, as you can see, we don't do these very often.

Q53 **Dame Meg Hillier:** Yes. It is a long time since we have discussed this at the Commission.

Gareth Davies: It typically happens where the case falls short of the ill health retirement rules, so it does not qualify as an ill health retirement, which is a call on the pension fund, but for the individual, through no fault of their own, it's time to call it quits. I am not going to talk about this case, but typically that is what these are. But this is obviously very selective; it is done where there is no other sensible route.

Q54 **Dame Meg Hillier:** I can't remember the detail, but I think the last time I saw it was under your predecessor—there were some exit packages. Can you remember one in your time, Mr Lambauer?

Daniel Lambauer: We had one similar one last year. I think—this was before my time—we did have some more high exit packages before the civil service rule change, but you can look back at our accounts and we have one, maximum, every year—something like that.

Q55 **Dame Meg Hillier:** These packages presumably have to go through the board, Dame Fiona.

Gareth Davies: It depends on the level of them, but typically, yes. Obviously, they are significant individual amounts, but they are all within the rules. Although we are not part of the civil service, we use the civil service scheme. All our staff are in the civil service pension scheme, so those are the rules we use for this.

Q56 **Chair:** I have two more quick questions. One is about the energy support schemes which involved enormous public resources unexpectedly. How did that affect the allocation of your resources?

Gareth Davies: It was a significant part of the responsive chunk of our audit programme. We reserve part of our VFM resource for responsive work, because although we don't know what it will be, we know we are going to have to do something at short notice. This was the biggest single one that we did in the year that we are looking at. We were able to produce a Report to support a PAC session in, I think, February or March for a scheme that was implemented in the autumn, so it was a really fast turnaround. It did take a significant amount of our responsive work, but that is what it is for. That resource is there for exactly that purpose. It did not mean that we had to pause planned VFM work; we were still able to do our substantial VFM pieces.

Q57 **Chair:** What about Ukraine? That also has been a huge commitment for the UK Government. What has that meant for the NAO and your audit programmes?

Gareth Davies: The impact has been less direct. Our first dedicated piece of work on that is coming up. We have just started work on the Homes for Ukraine programme, which DLUHC is responsible for—that is getting under way now—and obviously our MOD audit has had to heavily consider the use of MOD resources around this, but again, we have been able to cope with all of that within the response element of our programme.

Chair: That's brilliant: we have come to an end just as the voting has commenced. That ends this evidence session. Thank you all very much for coming today. The Commission will now deliberate—briefly, I think—in private.