

Public Accounts Commission

Oral evidence: National Audit Office Main Estimate 2022-23

Tuesday 1 March 2022

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Members present: Mr Richard Bacon (Chair); Jack Brereton; Anthony Browne; Clive Efford; Peter Grant; Dame Meg Hillier; Sir Edward Leigh.

Questions 1-68

Witnesses

I: Gareth Davies, Comptroller and Auditor General, National Audit Office, Daniel Lambauer, Executive Director, NAO, Dame Fiona Reynolds, Chair, NAO and Janet Eilbeck, Chair, Audit Quality Board, NAO.

Examination of witnesses

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

Q1 **Chair:** Welcome to this meeting of the Public Accounts Commission on Tuesday 1 March. We are joined by the Comptroller and Auditor General, Gareth Davies; Dame Fiona Reynolds, the chair of the National Audit Office; Daniel Lambauer, the executive lead of the National Audit Office; and Janet Eilbeck, a non-executive director of the NAO. You are all very welcome. We have before us a variety of documents and we are considering the NAO's strategy and the estimate.

Mr Davies, you have asked to retain £2.1 million of previously provided additional money for another year. Can you say why this is?

Gareth Davies: If you remember, the case that we made this time last year for that additional resource was based on the audit work that would be necessary to deal with the impacts of the Government's pandemic spending on the accounts, primarily; and as we say in the document, we did need that. We have just, at the end of January, completed the audit of the final Department for '20-21, which was the Department of Health and Social Care, which not surprisingly was the most complex and most difficult set of accounts to audit for that year, and in fact the most difficult we have had for many years of any Department.

As we expected, it was a challenge to audit those brand-new streams of expenditure on PPE, the vaccine programme, the Test and Trace service—all of them very significant audit risks in their own right—so that resource was all required for that work; and as we know, and we didn't know this time last year, dealing with the pandemic has occupied a lot of '21-22 as well. A lot of those spending programmes continued into that year; the furlough scheme, as you remember, was wrapped up in the autumn; we have had to deal with subsequent waves of the pandemic in health spending, including omicron. We also know what is in those accounts in much more detail than we did this time last year so, as you will have seen from the coverage of the various audits, there remains a lot of audit work to do on, for example, the PPE inventory at the Department of Health and Social Care. I had to qualify my opinion on the accounts because of the inability to verify that balance, the lack of stock checks. We still expect significant challenges in getting control over that stock and arriving at an auditable valuation of it at the end of this month. So there remain those issues.

You will have seen the coverage of the levels of fraud and error in several of the pandemic spending programmes—the bounce back loans programme, where obviously this is about how much of the Government guarantee will be called in, and how much of that is due to fraudulent loans. There is fraud and error in the furlough scheme and in the universal credit system that surged through the pandemic, and also on local



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authority loans for local businesses funded by BEIS—so very significant levels of fraud and error already identified by those Departments in those areas.

We are expecting their estimates of those amounts to be much better at the end of March '22 than they were a year ago, but clearly that is going to take a lot of careful auditing as well. I am painting a picture that the additional audit work that was necessary last year is still necessary for the '21-22 accounts. We are confident it does look—touch wood—as though that will be reducing in subsequent years and as you will have seen, we are proposing to return that additional amount over that period.

Q2 Chair: Yes. So you are saying in the estimate that it is current planning assumptions that you think you will get back to normal and not need this extra money by 2024-25. Basically, what are those planning assumptions?

Gareth Davies: That the Government does not need to relaunch any of its pandemic spending schemes to any level of significance, and that it continues to get better control over the amounts spent, and therefore better valuations, better estimates of fraud and error that do not require as much detailed audit work as they have done. At the moment I am reasonably confident about that, but we have to say they are planning assumptions and we will have to see how events turn out.

Q3 Dame Meg Hillier: Mr Davies, you mentioned fraud and error, and obviously there was a lot of publicity around this, particularly when Lord Agnew resigned, saying he felt Whitehall didn't have a grip, to paraphrase him. Could you tell us which Departments you found have had a better grip of it than others? You talk about getting it back on track. Are you confident that they will actually be able to drive down and recover some of those moneys? Give us your best guesstimate at this point.

Gareth Davies: On the first point, not surprisingly, it is those areas that were not used to operating very large payment schemes, which had to be designed almost from scratch in a matter of weeks and implemented very quickly. Obviously, that was a big success in those terms—the furlough scheme was able to be stood up very fast, similarly the bounce back loan scheme—but, in both cases, they were knowingly entered into with a higher level of fraud and error than you would normally tolerate with proper time to develop and test a new system. Both were covered by ministerial directions sought by the accounting officer, who could see the level of risk involved.

I am not sure they anticipated quite the volume that was going to transpire, but the proper governance process was followed in those cases, whereas those Departments that are more used to dealing with high volumes of payments, like DWP for example, still suffered with higher levels of fraud on universal credit in the early stages of the pandemic, but there has been better information about the likely impact of the controls they have had to release—they had to stop, for example, face-to-face



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verification meetings at jobcentres. They estimated what that was likely to cost in higher levels of fraud and they were broadly right actually, so it was more about their ability properly to quantify the effect of reduced controls and then regain control quickly, whereas for the new systems, there is still a big challenge in getting to the bottom of fraud and error—in the bounce back loan scheme, for example.

- Q4 **Chair:** I am interested that you said they were perhaps surprised by the level of fraud. I remember the leader of my local council, South Norfolk Council, Councillor John Fuller, who is a businessman with many years' experience, saying at the time, in the early spring of 2020—obviously the council had many new responsibilities to take on, which it did very well—to me and others, "Do you have any idea how easy it is to imitate a company?" This was when the new schemes to support companies were first being launched. That information was fed in—I think many people did the same. I am not across all of the 29 studies that you have done; it is extraordinary that you have done so much work on the pandemic. What answer have Departments given to the question that they were warned?

Gareth Davies: Their answer is always about the time with which they had to mount these schemes. The clear instruction from Ministers in each case was, "Speed is more important, and so we are knowingly taking a risk there."

There is a lot of learning to come out of this. Having now been warned about this, and in the hopefully very unlikely circumstances that we have anything like this again, we need a much stronger toolkit available to each Department so that these things can be brought in very fast again but with far less risk involved.

There are also a broader set of issues about controls over companies. You mentioned an example. We are learning a lot about how we get better control over what is a surprisingly easy thing to do—setting up a company, which gives you as a director of that company access to these schemes and quite a lot of control and power. It is extremely easy to do that at the moment. There are some interesting questions about how we want the overall control framework to operate outside an emergency situation.

- Q5 **Clive Efford:** You say you are going to return the additional funding by '24-25. How much of the work that you have had to do during the pandemic are you going to have to continue? Has your workload increased as a result of the pandemic? Is it likely to stay like that?

Gareth Davies: Other things are affecting our workload. We have been very careful here to isolate the need for extra resources caused by the pandemic spending, and I think that will go down to previous levels. Obviously, some of these things will remain on the balance sheets of Government Departments. The Business Department will be dealing with the bounce back loans liability through the guarantee scheme for some years, but they will be much more stable—they won't have issued any new loans, and it will all be about better understanding repayment rates and so



on. That is why we expect that audit work to go down, but other things will change.

We do itemise other changes going on around our audits, outside the pandemic. For example, the new audit risk assessment standard, which is called ISA 315—all auditors in every sector are having to implement that from this year, so we have included an estimate of the impact of that on our workload. Similarly, there is the shift towards a greater use of IT audit and so on. I just want to make the point that it is not a static picture. A lot of things are changing in the audit workload, but we thought it was really important to be accountable for the increase that you all approved last year for the pandemic work. By '24-25, we are confident that will have gone.

- Q6 **Clive Efford:** On the bounce back loan scheme, the Government are today going to bring forward legislation to deal with money laundering, and one of the issues that they are to deal with is Companies House and how easy it is to register companies there. Is anything you learnt on what you have done so far on the bounce back loan scheme informing what is before the House today?

Gareth Davies: Yes, and the Public Accounts Committee had a discussion on exactly this topic with the permanent secretary of the Business Department last week. It opened up several avenues that have been exposed by what happened in the pandemic. Actually, they have been there for some time, but the fragility of that system and the scope for better control over it in quite a few areas have been identified through the work that we have done on the pandemic and reported to the PAC. That is a very live discussion. The permanent secretary was pretty proactive in suggesting areas that they were considering for improvement and reform.

- Q7 **Clive Efford:** You said that those problems have been there for some time. Had you identified them before?

Gareth Davies: Not in the way that we have now because, obviously, this kind of mass abuse of the Companies House system for the purpose of extracting Government money was a new phenomenon. No—we had not seen it exposed quite as brutally as it was through that scheme.

- Q8 **Peter Grant:** Good morning, everyone. To be fair to the permanent secretary, with hindsight, she obviously knew last week what the Government were going to announce this week, so she felt it quite safe to criticise the existing system, because she knew that they were going to be looking to change it quite quickly. Mr Davies, you said that the NAO had not really looked in great detail at the opportunities for abuse of the companies registration system until the pandemic and all the concerns about fraud in the various covid support schemes. Is that because previously, the baddies had been using the system to defraud members of the public and businesses, whereas this time they were quite clearly using it on a massive scale to defraud the Government and the taxpayer? Is that the reason why it might not have come on to your radar previously, although it should have been picked up elsewhere?



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Gareth Davies: I can only speak for my time in the role, when we have not focused on Companies House as an audit topic in its own right. I am sure that there has been previous NAO work on that, under predecessors. But yes, we are the public spending watchdog, so our core remit is where public money is at risk and, absolutely, that has focused our attention through this extraordinary period.

Q9 **Chair:** You mentioned workload, and one other area of workload that you identify in the estimate is to do with new accounting standards, particularly ISA 315. You say that that will require you to spend a lot more time—I think, 25% more time—on the planning for audits. Does that represent a challenge, doing that at the same time as you are already issuing audit opinions later than you had previously been doing?

Gareth Davies: Yes, 25% of the audit planning element of the budget, so that is obviously only a small part of the total audit resource. We have been building up to this for some time anyway. It has been clear what is coming. Essentially, it is a more structured way of guiding the auditor through, and documenting, the risk assessment that leads to the programme of audit testing that we go on to do. Janet may want to come in, in her audit quality board chair role, to add to what I am saying.

Profession-wide, this is a big job, and there is clearly a significant training programme. It coincides with our audit transformation programme, so we are using that programme to bring this improvement in planning in at the same time. We have a tool developed as part of our new software package—it is the first bit to have been developed—and that is now being piloted by some of our audit teams, prior to the full roll-out of this new standard from the autumn onwards.

That is looking very good—all the feedback from the teams piloting the tool is that they welcome the clarity and structure that it provides. The way I'd sum it up is that it is making it easier for auditors to do the right thing and harder for them to do the wrong thing—

Chair: Because it is such a clear framework.

Gareth Davies: Because it is structured and alerts you to things that you might have missed, or to inconsistent bits of documentation.

Q10 **Chair:** In a way, it is no different from the approach to quality in ISO 9000 or ISO 14000 for the environment, or whatever. It is a strong framework. Is that what you are saying?

Gareth Davies: It is. There are some risks with implementing any change like this, because clearly auditors become used to the previous standards. Previous experience tells us that this is going to take a big effort across a large organisation, so we have a suitably large programme of training, and we will return to it as well. It is not the kind of thing where you send somebody off for two days to be trained and that is it; we have to continue to embed this learning, and will be reviewing a higher proportion of our own audits than we normally would to check that this is being implemented properly. It is a significant change effort.



Chair: Janet Eilbeck, do you have anything to add?

Janet Eilbeck: Gareth has covered most of the points. The planning stage of an audit directs the rest of the work, as would be obvious. It determines how much you do, how much you sample, how much you look at controls, and how much work you do in the most challenging areas because you have assessed the risk of material misstatement in those areas. It determines the work that you do later and hopefully makes that work more efficient.

Q11 **Peter Grant:** Mr Davies, you have indicated that you would expect staff numbers to remain the same—at 940—this year, and you have explained why in some of your earlier answers. You are then looking to reduce numbers to 926 and then to 915 the following year. What are the reasons for proposing that reduction, and how do you plan to manage the process?

Gareth Davies: That is all about the end of the extra resources that we sought from you this time last year to deal with the pandemic spending. The other big workload change embedded in those numbers is the end of the EU agricultural funds regime. That has obviously ended, but there is a run-off period that means that we have one more year of what we call agfunds claims in England, Scotland, Wales and Northern Ireland to audit. That clearly takes quite a lot of resource on our part. It also generates income from those other parts of the UK for us. You will notice that our income dips in the final year of our three-year projection. That is the agricultural funds effects, but that also has a workload and staff effect.

In the scheme of things, these are not significant numbers given the size of the NAO, and well within our normal levels. We are talking about 24 people over a two-year period. Normally we would have 60 people leaving in a year, and a big trainee recruitment programme each year. We are proposing just to manage that through careful workforce planning—managing our ins and outs so that we end up on the right level. Clearly, that is subject to any changes between now and then.

Q12 **Peter Grant:** How confident are you that the 60 people will leave from the areas where you would like to reduce numbers?

Gareth Davies: It is not as if we have people who can only do agricultural funds audit, for example; that is done by audit teams—

Q13 **Peter Grant:** Rather than look at subject, what about if we look at the level within the organisation—for example, new entrants, and highly qualified and highly experienced staff. Are you confident that the sort of level in the organisation that people are likely to leave from matches where you would expect to see numbers fall?

Gareth Davies: Yes. By far the highest turnover levels are in our AP grade—our audit principal grade—which is our newly qualified grade, and our analysts, which is a smaller number of people. The workload changes that we are talking about affect our audit teams, so the reduction will be concentrated in the part of our skill mix where we get highest turnover.



Q14 Peter Grant: Thank you. Let us move on to staff costs. You have asked for a budget increase to fund a minimum pay increase of 2%, averaging out at 3% because some staff groups will get more. How did you arrive at the minimum figure of 2% and at the suggested differentiation of pay rise for different grades of staff?

Gareth Davies: We have a long-standing issue of pay inequalities within grades, largely because people who got promoted a few years ago, before a long stretch of austerity pay increases, have moved up the grades. People promoted more recently have not had big increases; that has allowed a gap to open between people who are pretty much doing the same job. We need to address that. That is one input into that process. Every year, a key factor that we look at is any pay-level expectations set for the civil service or the wider public sector. We do not know what that is yet for the year that we are discussing here, but we think where we have pitched that is reasonable in light of what we might expect for public sector pay. Crucially, we look at benchmarking information about how our pay at each grade compares to the equivalent in the private firms doing audit work. That is, in practice, where we both recruit from and lose our staff to. That benchmark is showing that our position has slipped a little compared to the private sector, but not so much that it shows a higher increase is necessary.

The proof of the pudding is in our turnover rates. I mentioned that our audit principal grade is the key one when we are talking about turnover; turnover is very low with audit managers and directors, but at audit principal level we are running at 16% against our target of 15%. We are there or thereabouts on target, but it is not comfortable. Every 1% increase is four or five of our audit principals leaving. We are watching that very carefully. It is quite a buoyant market for audit skills at the moment; firms are strengthening their audit teams under regulatory pressure, and fees are going up in the private sector, as we indicated in the document. I am not complacent about that.

If you add in to that the cost of living increases that everybody is seeing—not just NAO staff—there is significant concern among our staff. I am not hiding that from you; they are concerned about the squeeze they are facing, particularly after a pay freeze last year. The pay assumption is the most challenging assumption we have had to make for this document this year—more challenging than in previous years. We feel under greater pressure, and this is the minimum to ensure that we both do not fall too far behind the rest of the market and deal with the pay inequality point. That is where the 1% will be targeted. For people at the bottom end of our pay scales, we have not finished the precise modelling yet, but they will be looking at more like a 4% or 5% pay increase—which is obviously much more significant.

Dame Fiona Reynolds: May I add on that, this is something the board and the remuneration committee spent a good deal of time on. It is a judgment, and we are in a position where we do not yet know what the civil service settlement will be. There are huge inflationary pressures in the wider community. We watch the private sector very closely, and we



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expect there to be higher pay settlements there—there often are. I wanted to register that this is something that we will have to watch. I suspect that 3% will not look at all generous in a few months' time. However, we are putting this forward as our best and considered judgment that it is the right thing to do at this point. We should register that this may be something that, in the fullness of time, we need to talk to you further about. Obviously, we all hope that we can manage it. It is a judgment at a difficult stage in the timing.

- Q15 Sir Edward Leigh:** We notice that you are trying to recruit new audit principals; is there a problem with their salary? Are people leaving? What is the reason for that?

Gareth Davies: At the moment, our turnover at that grade is slightly above our target, but not so much as to be of immediate concern. By the time that indicator is showing a problem, it is too late to get those people back. That is why we are on this like a hawk. We have been able to recruit, and we are currently recruiting successfully for audit principals from the external market. It is not a disastrous picture at this stage. At the moment, that is reflecting pressures in other bits of the audit market. For example, if firms are deprioritising their work in local government audit, we are able to attract people to us because they are qualified to do the kind of work that we do. I have mixed feelings about that, as a former local government auditor, because I want to see that regime strengthening, not weakening. It is, at the moment, proving possible for us to recruit at audit principal grade. It is too early for us to sound the alarm on this, but, as Dame Fiona said, we will come back to you if necessary with a supplementary if this starts to accelerate out of our reach. At the moment, we do not think it will.

- Q16 Chair:** Dame Fiona mentioned the general inflationary pressures. I saw a prediction in the newspaper the other day of 8% inflation at some point. You do audit the Bank of England, so I wonder if you have any plans for a value for money study on the Central Bank's ability to safeguard the value of the currency.

Gareth Davies: Not yet. That would be a stretch from our previous work with the Bank.

Chair: But it is within your remit, is it not?

Gareth Davies: Value for money studies are, but carefully described as being within the NAO's sphere of competence.

Chair: Economy, effectiveness and efficiency surely extend to having a sound economy. I remember, admittedly as a child, 27% inflation in this country. It is not an idle point.

- Q17 Sir Edward Leigh:** May I ask what salary they get? We have noticed that in the private sector, an assistant manager is getting £52,000. That is less than an audit principal, isn't it?

Gareth Davies: No. The grades are sometimes differently expressed. Broadly, we are close to the market rate for trainees, audit principals and,



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in most cases, audit managers. Once you start getting to the senior end of audit manager, and certainly directors, the firms pay significantly more.

Q18 Sir Edward Leigh: And then of course it goes exponentially up.

Gareth Davies: Yes. This is the NAO. We do not compete with partnership profit shares in the private sector, and we never would. We attract people because this is the kind of work that they want to do and only the NAO can allow them to do it.

Q19 Sir Edward Leigh: The trouble is that you are competitive up to the junior levels, until they are about 30 or so, and then of course they are all leaving because they can get so much more in the private sector.

Gareth Davies: Only 16%, so 84% are staying. This is still quite a healthy operation, and our ability to resource our work depends on us holding that level of turnover to no higher than 15%. Obviously, any less than 15%, there is nowhere for newly qualified people to go, so that becomes a problem in its own right. At the moment, this is a broadly healthy level of turnover. It is just that we are hearing far more squeals of pain on pay than we have in previous years. We understand what is going on in the private sector, where there are opportunities for people. This is high risk, but not, at the moment, causing us operational difficulties.

Q20 Peter Grant: I do not know whether you have seen the email that the Chair received from the PCS union. I would imagine that they have made similar representations to you anyway. You have possibly addressed some of the points that have been made. I just want to give you some of the statements of fact that they have made, just to confirm whether you accept the accuracy of them. First of all, they said that for years, pay awards at the NAO have been much lower than the average public sector pay award. Is that a fair statement?

Daniel Lambauer: My understanding is that it is not. There are different public sector pay awards. Nurses get a different pay award, as you know, and frontline staff such as civil servants in certain Government Departments. Generally speaking, our pay awards have tracked those over the years.

Gareth Davies: Certainly in my time—this is my third year—obviously, last year was a pay freeze for everybody, so it was the same; the year before, we were at 2%, and I think that was roughly the level in the civil service. In that time, we have been tracking the civil service level.

Daniel Lambauer: I think the problem we have always had, coming in to the Commission, is that the central civil service pay award is awarded after we have these hearings.

Q21 Peter Grant: I think the comparison the union are seeking to make is with average pay across the public sector. Certainly, the public who pay their wages do not particularly care whether they are civil servants, local government workers or where they are. Do you proactively track your own pay awards compared with the wider public service outside Whitehall?



Gareth Davies: At headline level we do. The detailed benchmarking we do is with the firms, though, because that genuinely is where the market for our staff lies. Obviously, we do lose people to finance roles in other public sector organisations, but the firms are the clear comparator.

Daniel Lambauer: We have discussed with the Commission before that we pay due regard to civil service pay, as per the legislation, but our main competitors, in terms of staff, are the audit firms. In previous years, we had up to, in terms of people leaving, around 40-ish per cent. in the accountancy market—more than in the public sector market—so that's what we always benchmark against.

Q22 **Peter Grant:** Thank you. I have a related question about a statement that gave me some concern. The union are claiming that, in 2020-21, NAO staff worked a total of 123 additional unpaid hours. That is an average of 17.5 days per year per person that is unpaid. They reckon that if people had claimed for those hours, it would have cost you at least £5.5 million a year. Are those figures that you would recognise?

Gareth Davies: Broadly, yes. Any professional organisation—that's what we are—and particularly a professional audit organisation, understands that the annual work cycle is not flat. We have very significant peaks in our work—both VFM work and, particularly, financial audit work. It has always been the case with audit organisations in both the public and the private sector that we do expect our staff to put in additional time when it's necessary, to complete the work to a high standard and on a timely basis. That's working in a professional organisation. So actually that level of time doesn't alarm me.

We have very strong controls to detect whether any individuals are working excessive hours. This is driven by the level set out in the working time directive—48 hours a week. If we find—because we have a time recording system—someone recording over that level consistently, week after week, then their manager intervenes, we have a discussion with them and we work out how we can avoid that continuing. But that kind of level of work is what we would expect in the busy period, just for a compressed—short—amount of time. And that is exactly what it's like in every professional organisation. I don't want to pretend that everybody works their contracted hours every week of the year regardless of the demands on us; that is not how this organisation works. But it is absolutely crucial that we reduce excessive working, which we have done successfully.

Q23 **Peter Grant:** Dame Fiona, may I come to you, as chair of the NAO board and having heard what the C&AG has said? What active steps does the board take to get absolute reassurance that the level of going above and beyond, which applies across almost the entire public sector, does not get to a stage where either it's unhealthy for individuals or it becomes toxic in the whole organisation? How do you make sure that people are not genuinely, or do not have the perception that they are, being pushed to levels that are just not acceptable?



Dame Fiona Reynolds: This is something that has been discussed at every remuneration committee since I have been a member of the board, and indeed at the board itself. We take it very seriously because, if you like, the contract we have with our staff is one with a high sense of public purpose and public duty and actually it's rather easy for people to feel that these interesting and challenging pieces of work they are doing—they do work very hard indeed to get reports done and to meet the demands of, as you have heard, a very demanding and important workload. So we have been working hard to ensure that there is the system that the C&AG describes, of active intervention by managers if people are recording excessive hours for no good reason. If a particular piece of work has to be finished, everyone agrees that has to be done, but we do look for opportunities for people to step back from a period of intensive work and to retrieve a normal life, and then not to ramp it up again unless there is good reason. So we do—we have asked the question regularly and been assured that there are those systems of intervention for the cases where excessive working is taking place.

Q24 Peter Grant: Do you make a distinction between excessive working that is unpaid and excessive working where someone is being paid for the extra hours?

Dame Fiona Reynolds: Well, the culture of the NAO, as the C&AG has described very accurately, is one of people wanting to do a good job. I think that is a very important and commendable culture. We do encourage people to manage, with their line manager, peaks and troughs in the workload, rather than going down the road of overtime and all the rest of it, so we try to ensure that a balance is struck overall.

Q25 Peter Grant: I am pressing this point because we regularly see media reports of other organisations in the public and the private sector where a culture has been allowed to develop that is utterly toxic and those at the top of the organisation, whether it's the chief executive, directors or non-exec directors, appear to be completely unaware of it. How do you make sure at board level that there cannot be things happening that you might be unaware of, and that possibly the C&AG and his senior management team would be unaware of? When you get down to some middle-tier line managers, how do you make sure that they are not feeling they have to squeeze the staff, for whatever reason?

Dame Fiona Reynolds: We have a very good system. I am sure Gareth will expand, but we take the temperature of how staff are feeling very regularly through a staff survey. In fact, we saw the results very recently at a meeting last week, so we really do ask, and we get raw data reported to us on how people are feeling. Actually, at the moment, the issue is pay, as you have already heard—I am not surprised. Working long hours was much less of an issue.

Gareth Davies: It is there. This is our survey that we have been running for 12 months now. During the pandemic, we obviously needed to communicate much more regularly with everybody, and that led us to move away from an annual staff survey to a monthly one. That is what we



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now have, so we do not ask the same questions every month—it is a different mix of questions each month—but staff have the opportunity to feed in, which means that we detect issues as they emerge much more quickly and we are able to act on them.

We get a really good analysis of the data, which now goes all the way down to team level, so it is not just our organisational groups: it is also right down to the individual team. If a particular team is showing signs of stress, we can now pick that up as well, and we take all of that data really seriously. We publish the scores in our annual report and accounts, and overall, our current staff survey scores are strong. Staff are feeling engaged, and we get very good scores on how well they feel managed by their line manager, which would be one of the sources of evidence that you would worry about if that was heading in the wrong direction, but the two areas that score the lowest are pay and workload.

There is clearly a workload pressure, and when we have been through what we have been through, which is a complete upending of our timetable for our work, with huge new areas of audit risk to cover—this has been hard work, and the teams have risen magnificently to it. It is a chance for me to thank everybody at the NAO for the huge effort they have put in and the huge skill they have shown in handling difficult and very unusual issues, but of course that has left us with a catch-up legacy. We have had to drag the timetables back, and this is hard work for teams. We have a detailed workload planning system that is telling us what each team needs for resources, and we are working to fill those now. It is a big focus, but on your question about, “What’s your warning system?”, I think we have a very good one.

- Q26 Chair:** That is a very comprehensive answer, and it is a good segue to the question I wanted to ask about the £1.4 million you are asking for to buy in specialist expertise. How will that planned external support be used, and what will it do to improve quality?

Gareth Davies: Again, I might ask Janet if she wants to add anything as well.

Essentially, this is part of our response to the challenge we have received from the Financial Reporting Council. Previous sessions of the Commission have heard evidence on where the FRC has identified scope for improvement in our approach. The key one, I think, is around these specialist areas of audit expertise. If you remember, we talked to you in some detail about the audit of financial instruments at the November hearing, but there are other areas, too—commercial contracts, pension valuations and asset valuations. Those are all specialist areas with entire professions geared up to arriving at these estimates, so the challenge for auditors is to understand the expertise that the preparer of the accounts has used in arriving at these estimates, but having enough of your own expertise to challenge them.

With this resource, we have a framework contract for various providers—some of the large accounting firms and others that are expert in valuation,



for example—and they serve as call-off contracts for when we need a particular type of expertise for a particular audit. The teams have access to those to draw down what they need when they need it. That is the framework, but Janet, do you want to add to that?

Janet Eilbeck: I was going to make a comment about size. Audit firms that are similar in size to the NAO may well choose their areas of specialisation—they might look at charities in particular, or pensions or other areas—but the NAO has to be competent in everything, yet it is not a huge organisation. You don't always need the same level of expertise for a whole year or across time, so it makes sense to buy in additional expertise. The second challenge that the NAO typically has is that some of these very technical areas of accounting—the C&AG has talked about financial instruments as being a particular problem, but also asset valuations or commercial contracting—are things that the Government financial accountants themselves have not had a great deal of experience in and they perhaps find it harder than their private sector counterparts might to provide the necessary support, evidence and argument in those areas. Therefore, the NAO is starting from a more difficult place when it starts to audit those.

Q27 **Chair:** You are saying—I think this is referred to in the estimate, actually—that as an organisation, you may never have the economies of scale to justify having these experts on board the whole time. At the same time, there is the question of skill transfer and making sure that the skills that are needed and the ability to buy those skills, which is part of the skill, is kept up to date. How do you do that?

Janet Eilbeck: As somebody who used to provide audit work and skills to the NAO many years ago, the NAO has always been very good at that. It typically moves the work that it contracts out around from area to area, so it will learn from what a new set of eyes and a new set of skills can bring to a particular area and absorb that and work with it by reviewing it closely and take it into the organisation. Typically, the NAO has always been very good at that.

Gareth Davies: On these areas of particular specialism, if we take pensions for example, we have a small centre of expertise team for pensions headed by a director, we have one of those for financial instruments, which we are now strengthening following the feedback that we had last year, and for other technical areas as well. So through that combination of outsourced provider working closely with a team that is dedicated to that area of expertise, they become very expert as a result of that contact with the specialist from outside, but we are never able to make those teams big enough to be self-sufficient. I think that is Janet's point. However, that mechanism works well.

Q28 **Clive Efford:** I do not know if this is the right point to raise this issue, but there is a great deal of concern about the ability of enforcement and regulatory bodies to make the sanctions that we are discussing in Parliament stick, with a lack of resources to be able to take on the huge resources that these oligarchs have, laundering dirty money, setting up



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shell companies, avoiding paying tax and all the rest of it. So are the organisations that you are auditing, the public organisations that are going to be tasked with pursuing those people, are you satisfied that they have the expertise and resources they need?

Gareth Davies: It is a big challenge. I like to try and use a detailed evidence base to answer those kinds of questions from our work and we have not recently carried out a value for money audit of, say, the Serious Fraud Office or any of the other enforcement agencies in that space. Although, our audit of the SFO's accounts for the most recent financial year identified that because of the collapse of one of their cases they had overspent against their cash limit. The Public Accounts Committee held a session recently for the head of the SFO to come and explain how that had happened and what they were doing to avoid similar things in future. So that started to open up exactly the kind of questions that you were addressing.

Those organisations are very important, but they are quite small, so when we are working out how to allocate our scarce value for money audit capability each year, they sometimes struggle for prominence in that programme against some of the very large areas of value for money risk we are dealing with, but we do tackle them.

One current example is that we are about to publish a report we have done on the performance of the regulatory system around British Steel pensions. You will be aware of that big issue of British Steel pensioners being advised wrongly to exit the pension scheme. We are looking particularly at the role of the Financial Conduct Authority in that case. Obviously, our findings there will be relevant to whatever happens in the future of regulation in that space. We do look at these kinds of organisations, but it is a challenge to get around to them on a regular basis for the reasons I have given.

Q29 **Clive Efford:** If I can push you a little bit more, when you see what seems to be a new area of regulation and enforcement opening up and we see the huge resources that are available to those people who seek to hide their money and launder it through the City of London using various companies, does that suggest to you that there is an area there that needs to be urgently looked at?

Gareth Davies: It does. We are in the early stages of a piece of work looking at how Government are tackling fraud more broadly in the private sector. Going back to the point we discussed earlier, it is not just fraud against the taxpayer, but the Government's broader strategy for counter-fraud activities, including money laundering and the kind of things you are describing. That work will touch on this point.

As you say, the capability of the organisations which are going to be given additional tasks is critical. When the impact of the legislation is clear and we understand who is being asked to do what, then we will follow that up as part of our work.

Q30 **Chair:** When you mentioned some of the organisations like the SFO being



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quite small and therefore struggling for attention from the NAO, given your relatively limited resources and the amount of ground you have to cover, you prompted a thought. What method do you have for ensuring that the smaller organisations from which one may learn important lessons are given attention?

The Revenue and Customs Prosecutions Office, when HMRC hived off its prosecution activity into a separate body for a while, was tiny in NAO terms—I think the total income and expenditure was around £20 million. You did a report on it that showed that the first act of the chief operating officer when he was appointed was to award his wife £100,000 of HR consultancy. This raised one or two eyebrows, even though she was an HR consultant. That type of lesson is very important to capture, and you do not want to not capture it just because it was a small organisation.

Do you have a system for making sure that that problem is addressed in a productive way?

Gareth Davies: We do, yes. The process of determining our work programme on the value for money side, where we obviously have a lot of discretion but a huge field to cover, is quite well developed. Each of the teams responsible for each departmental area co-ordinates a joint risk assessment between our financial auditors and our VFM teams. That is designed to flush areas of VFM risk; some of them are obvious, but quite a lot are less obvious. We then always stand back from the programme to check that it has a proper balance of reviews of major infrastructure schemes and those kinds of things that require NAO attention.

But as you say, there are also what our permanent secretary once described to me as dusty corners, where pretty significant risk can be building up but not spotted by us or the Government. We have developed a way of trying to identify what those might be. It is difficult by definition because they often stay hidden, but that has led us to do work in smaller organisations on less obvious topics, and we continue to do that.

The example that brought it home to everybody was the tragedy at Grenfell, the fact that clearly things had been happening in the regulation of building materials that needed attention far sooner than it got it.

Chair: Someone very senior in Whitehall described it to me as having turned into a cottage industry.

Gareth Davies: Exactly. It is how we pick those areas up before it is too late, rather than after the event. Testing our plans to make sure that we have not missed any important areas like that is a major preoccupation for us.

Q31 **Chair:** Mr Lambauer, I would like to turn to the building. Your rental income is set to increase as you rent out a greater proportion of the building. Obviously, not only because of the pandemic but because of new ways of working, you are not occupying all of the office space. It has not been that many years since this Commission approved the budget for the office refurbishment, and you came into the Commission regularly to



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give evidence on the progress of the building, as did your predecessor Michael Whitehouse.

Where are we now? Is it going to be sensible for you to retain this building if you have, according to your estimate, eight floor spaces—I think that means four floors in two wings—of space that you are renting out? Does the NAO plan to become a landlord, or should you be thinking of selling the building at some point?

Daniel Lambauer: In terms of our estate strategy, that will definitely be a feature as part of the next strategic review, post-pandemic now. There are also questions, which you may come to, about the Newcastle office and other satellite offices, potentially. We are starting to look at that.

We will understand a bit better in the next years how hybrid working is going, working from home versus working in the office. We will also see where Government Departments are moving their finance teams, which is now emerging slowly. Hopefully, the market will also settle down a bit more, so that gives us a better understanding of where the market is moving.

What I would say, though, with the BPR building, which we refurbished in 2009-10—I remember because I had just joined the NAO at the time—is that it is on a peppercorn rent lease that still has more than 100 years.

Q32 **Chair:** You have more than 100 years left?

Daniel Lambauer: Yes. We are basically paying for the maintenance of the building. If we were to rent out at the current market evaluation, 100% of the two wings we want to rent out, we would make around £3.5 million rental. That gets us a huge chunk to maintain the building.

Q33 **Chair:** Are you yet cost neutral, in effect? Or is that an aspiration?

Daniel Lambauer: To be cost neutral long term, the rental value needs to rise further than what we are currently estimating. It costs around £4.9 million to run the building, roughly speaking, so we have a bit to go. Obviously, if the market goes in the right direction, that would be possible. Also, if you make other savings on other running costs of the building, such as energy savings etc.

But it gives us a huge chunk basically to run the building, not entirely, but a good way to cost neutral. That has to be factored in, together with looking at the legal basis for all of that. We have only started to look at this. The building was given to us; it is not part of the civil service. Then there are relocation costs, re-rental costs, so—

Q34 **Chair:** It is not as if the long-term outlook is going to change. We are always going to need a supreme audit institution, not just for the foreseeable future but, hopefully, always. Presumably, there is an argument you are weighing up, that you have actually got a rather good deal.



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Daniel Lambauer: Yes, where we are standing now. That is why I am saying that we are starting to look at it, but I think the deal overall is quite good.

Q35 **Chair:** C&AG, did you want to add something?

Gareth Davies: Only that, with levelling up being such a dominant priority for the Government, we are coming to the end of our current lease in Newcastle. We are committed to the north-east and have a fantastic team of people based there, so we are going to replace our office in the north-east with another one.

With levelling up, as we understand a bit more about exactly where Departments are going, that does make us think about whether we should have a second base outside London. We are nowhere near a business case on that, certainly not a decision, because we want to see how things develop before we commit and get anywhere near that.

I can imagine, for example, that there may be a compelling argument for having a west midlands base, if significant parts of central Government are basing themselves in that region. That would then give us a more balanced footprint across the UK. That is speculation, but I am just giving you an indication that we have an open mind.

I don't think any of that means our walking away from what is an incredibly valuable asset to the NAO. That building is almost like a character in the organisation and, crucially, exactly where it is means that we can be efficient in our work with Government. It would have to be an extraordinarily good opportunity that was better than that.

Q36 **Sir Edward Leigh:** I was going to ask about that because it is obviously a beautiful and historic building, being a former BOAC building and all the rest of it. How important is it for your prestige that you have such a distinguished building? If we were looking from a purely hard-headed point of view, is it really necessary for you? Maybe it is; I am not saying you should. I am just interested in your point of view. Does it add to the image of your organisation, being in such a distinguished building?

Gareth Davies: If its cost were commensurate with its impact and prestige, we would have a more challenging business case to make. It is the combination of a highly effective building, even though it was built in 1939, that works very well for us. As you say, it makes a big statement about the importance of public audit. That is not insignificant, but I would be loth to be paying through the nose for it. Actually, this is an incredibly strong economic proposition for us, so to be able to have that combination at the moment feels exactly right. That is what I mean when I say it would have to be an exceptionally attractive alternative offer for us to move away.

Sir Edward Leigh: My personal view is that it is very important for the image of your organisation that you are in a distinguished building. But you have to make the economic case as well, which you have done.



Chair: I agree. Peter Grant wanted to ask about the audit transformation programme.

- Q37 **Peter Grant:** To save time, I will not repeat the questions that I asked when you appeared before the Public Accounts Committee, because the commissioners have all been given a transcript of that. You have taken the decision to capitalise quite a significant amount of expenditure on this. My understanding is that the original intention was to see if you could get something off the shelf, possibly on a year-by-year licensing arrangement, which would have put all the costs into revenue. Could you explain why you have decided to build your own, rather than buying and possibly adapting something that is already there?

Gareth Davies: My instinct on these things is always to buy off the shelf where possible, having seen lots of other organisations get into difficulty by not doing that. This is not where we set out to be, but the market does not offer what we need—that is the crucial thing. That is not the NAO being precious and over-specifying its requirements. We have been challenging ourselves on that but, essentially, the audits we carry out at the top end are the size of the audits that the big four deal with. We audit the BBC and the Ministry of Defence. These are very large, complicated group audits, with all sorts of significant entities built into them. No off-the-shelf audit software package is capable of delivering the quality audit that we need for those kinds of organisations, because the only other people who do audits like that are the big four and the challenger firms in the next category. They all develop their own software, and they will not license it to anybody else, so the market was not able to provide anything off the shelf.

But we are not going in with a blank sheet of paper either. I am actually signing the contract with our commercial partner for this procurement later today. Essentially, they build in the Microsoft environment, using a standard set of tools to build a pathway system. That is what this is—it will be a workflow system with the kinds of controls that I mentioned earlier, to help people do the right things and avoid doing the wrong things. It is a question of bolting together established working components to deliver an audit system. We have seen enough already to know that it is pretty much almost there, so this is not blue sky thinking.

We are not trying to invent something that nobody else has seen, and we expect to have a working prototype of the whole thing by this autumn, which also indicates that this is not a multi-year, complicated exercise. But it will be unique. There will be nothing quite like it, and we very much hope that this will be of interest to audit agencies around the world that find themselves in the same position as we do, whereby they are auditing very large, complex entities but cannot acquire software off the shelf that is capable of supporting those audits. We have made sure that we retained the intellectual property in the agreement, and we will be looking to make full use of that if, as we expect, this works well.

- Q38 **Peter Grant:** The software will obviously not be of the scale and complexity of some of the software development exercises that you have



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audited and reported back to the Public Accounts Committee, but from your experience of some of those audits, you will know just how easy it is for these things to go horribly wrong. How confident are you that you are not making the same mistakes that everybody else in Whitehall seems to make?

Gareth Davies: As you can imagine, this is a regular topic of conversation for our management team, the project board and our board. All our board members have scars on their backs from other organisations with similar projects, so you are absolutely right about the risks. We have less excuse than anybody else not to know what they are and to manage against them, so that is what we do. It must be horrible being a project manager in the NAO, because people like me are always quizzing you on how you have managed the risks that we know so much about. The team is doing a very good job of that. The contractor that we will be working with also has a strong track record. As you would expect, we have checked out its similar projects. They are not audit projects but, for example, the contractor that we are working with has recently supplied a major new system to the Land Registry. We have seen that working in practice, and have had proper feedback from the people who commissioned it and so on.

We are doing all the things that you would do to minimise the risk that something goes wrong: a very good due diligence process; working with proven expertise; and a contract that properly aligns everybody's interests, so that the contractor gets properly paid for the amount that they are putting in, but that is also tightly controlled so that it does not run away. At the moment, we feel that the assurance framework is strong and has had all the right checks, but we are very alive to the fact that things can change.

Q39 **Jack Brereton:** You touched on some of the potential commercial opportunities of developing this software, and on retaining the intellectual property. Are you proactively looking at some of these commercial opportunities to generate new income streams for the NAO? Obviously, that may help you to better manage some of the budgetary issues that we have seen previously, where we are having to increase the budget. As you have touched on, we have a real asset in skills and talent, and other countries may be interested in buying some of that from us.

Gareth Davies: That is absolutely in our plans. We have been very careful. It was not a central part of the business case, because too often I have seen business cases approved with very ambitious commercial exploitation amounts included that have then not transpired. We are making sure that all the contractual documentation clearly reserves our intellectual property. We are going in with the expectation that we should be able to, with our partner, market this to other organisations. We are also ensuring that we are open with our peer organisations in the UK and around the world about what we are doing. Some of them are very interested to know that this is happening, and to get updates as we know how this thing is working in practice. Clearly, we will be in a much stronger position when we have a working version that we can



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demonstrate to people. We will not be there for another 12 months or so, but we are going to keep everybody in the loop and maximise the opportunities that it brings.

- Q40 **Jack Brereton:** Do you have anybody working on looking for and seeking out commercial opportunities, or is it just about randomly waiting for those to come along?

Gareth Davies: We have people working on ensuring that the contract is properly constructed so that we maintain control of the asset in that sense. We have continuous dialogue with our opposite numbers—other UK audit agencies and those around the world. We are on the governing board of the European Organisation of Supreme Audit Institutions. That is not the EU, but the broader European group of 50.

We also provide regular updates to our Commonwealth counterparts, who are very interested, because they have accounting and auditing systems that are closer to the ones that we work within. They are all aware of and interested in what we are doing. The great thing about this market of ours is that it is very clear who they are, and we work closely with them all the time, so it will not take us long to be able to demonstrate this tool in operation.

- Q41 **Peter Grant:** I have a quick follow-up question, if I may. Mr Davies, you said that you expect the software to provide benefits for the next 12 years, which is several lifetimes in technology terms, and probably a couple of lifetimes with the speed that audit is developing just now. How are you ensuring that it will still be useful in 12 years' time, and what provision have you made for the ongoing costs of developments, upgrades and changes so that it does not become obsolete?

Gareth Davies: The modular approach that I was describing earlier is a big strength. It is not like the old days, when you would buy a piece of software literally from a shelf that would come in a box, and you would load the disc and then have to buy a new one when it became out of date. This is much more software as a service. We can plug in new components as they become available and as new techniques become available. It is designed to be done that way, so it does build in that future proofing. Our business case for this does include regular development costs through that period because we are expecting to have to run routine updates every few months, but significant upgrades on occasion through the 12-year life of the project.

Daniel Lambauer: May I briefly add something because I also oversee our digital team? The way we are doing this is not just by relying on the external supplier. We have, especially on this technology stack, Microsoft Power Apps, which is a build-on, especially with FinancialForce, which is another system we have. We have our own internal expertise, which we are retaining, so there is a lot about capability building to make sure that we know ourselves how to continually upgrade the systems and make use of the latest developments in those technologies.

- Q42 **Sir Edward Leigh:** Since Richard and I started looking at these sorts of



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thing 21 years ago, we have seen so many disasters on software—so much pride and so many organisations determined to develop their own systems. You know, we don't want another NAO Report on the NAO and another disaster, starting with Tony Blair's new IT systems for the national health service 20 years ago and all that rubbish. Are you really convincing us you've done proper benchmarking, and this really is value for money and there is no alternative?

Gareth Davies: Absolutely.

Q43 **Sir Edward Leigh:** You absolutely cannot go back to somebody else—a proven system?

Gareth Davies: We tried very hard on this, and if the team were here, they would tell you about the conversations that we have had. I said this is probably the biggest call we are going to make, not scaling back. Essentially, we would have had to cut back our requirements for a capable system too far. That is where we got to. We would have had to, essentially, design our audits as though they were for small to medium enterprises, because that is what the off-the-shelf packages can deal with. One of the vendors of one of those was in the last two of our competition. They made strenuous efforts to convince us that that could happen, but when we looked at the compromises we would have to make on quality, insight and so on, they were too high.

Dame Fiona Reynolds: Can I add something? Janet might want to come in as well. The board have spent a lot of time on this. You can be sure that we have all looked each other in the eye and said, "We do not want to be responsible for a failure of the kind that we audit and criticise others for." We talked a lot not just about the technology, the budget and all the safeguards; we talked about the culture, actually, of implementing the programme and how we will know whether things—as they inevitably will, at some point—begin to go even slightly off track.

One of the things we have all learned from our own experience, but also from NAO Reports on others, is that the first person who has the courage to put their hand up and say, "Something's not quite right," is the hero of the hour, because that is when, before things start to go wrong, you come and analyse and understand. I think we have spent time looking at the culture of the team and the way in which we will be able to raise issues and concerns with our partner, so that we don't run a risk of something unfolding and us not being aware of it. We hope it will go absolutely smoothly, but, just from experience, we know that, at some point, something may happen. We want to be sure—

Q44 **Sir Edward Leigh:** You are wargaming all the risks of something going wrong there, as inevitably it will?

Dame Fiona Reynolds: Exactly, and the board that Janet chairs is also very, very engaged on the technical side too. Janet?

Janet Eilbeck: We have been looking at all three aspects of the programme—both the methodology side and the platform, so the pathway

through which it will be delivered, and also the capacity in phase 3 to continue to add new developments and new tooling to the system for the auditors to use. We have looked at all aspects of that. If I have a concern, it is about timetable. There isn't a lot of contingency. We have plans for piloting for roll-out, and making sure that they all happen on track—that whatever comes out of the piloting has enough time to be corrected, integrated into the main roll-out—and that the training for that roll-out goes well. All those things are things that we are looking at and making sure that the responses to those risks are being clearly dealt with.

Chair: I must say, Dame Fiona, I find your answer very reassuring because it reminds me of Cobb's paradox: the assertion that we know what causes software projects to go wrong and we know how to stop them going wrong, so why do they still go wrong? The answer, it turns out, is that it is mainly around culture.

Dame Fiona Reynolds: It is people.

- Q45 **Chair:** It is openness, people and communications, so I find that reassuring. It is also true that the compression of testing timetables and things like that, if you are enough of an anorak, sound like a big red flag. So it was a healthy warning from Janet Eilbeck that we do not have a lot of contingencies. We look forward to warm reports in future.

Gareth Davies: Just to say that this is not the kind of thing where we have no fallback option. I don't think we will need it. Our methodology is already compliant now with the new auditing standards. That methodology development has been completed and that work is finished. If we needed to use our existing system for another year, it would be possible to do that without any problem with compliance with the standards. We do not expect to use it, but that fallback is there in case there is concern about whether the audits will be completed.

- Q46 **Jack Brereton:** What sort of cost savings and efficiencies have been considered from implementing this system? Is that part of the things that have been factored in through developing the system?

Gareth Davies: It is a bit like my answer on the IP. This business case does not rest on our predicting a cut in the audit time required at this stage. Not only are we automating an existing process, but we are also implementing new auditing standards. We need the evidence of a couple of years of delivering audits against those new standards to understand what is possible. We are very clear that this will be more efficient in the sense of minimising the time that people have to enter data multiple times.

- Q47 **Jack Brereton:** It might enable you to do more.

Gareth Davies: Exactly. The business case rests on quality. Our aim here is to strengthen the quality of our audits and to use the power of an automated system to generate more insight into patterns of public spending. This isn't just pie in the sky. We have bits of this already emerging through data analytics work that we have been doing. We are



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expecting our audits to routinely deliver much more information about interesting patterns that suggest value for money questions rather than just accurate accounting questions, enabling us to integrate the findings of our two streams of work more effectively than we currently do. That is where this investment will really pay off.

If it allows us to save time because we have more efficient entry of data and so on, and with less rework necessary because we have avoided mistakes in the way I described earlier, we will quantify that benefit as well. This has not been developed based on an estimate of time saving.

Chair: That prompts a question that I want to ask about the skills mix. First, I think Sir Edward has a question about the Newcastle office.

- Q48 **Sir Edward Leigh:** By the way, to end that conversation, the problem that always goes wrong is that people view this like a Christmas tree. I recommend that you decide what you want to do at the beginning and don't keep changing it and adding new things to it, because that is what has gone disastrously wrong in the past.

Can you tell us a bit about your Newcastle office? Are you going to move into smaller premises? You have set aside £2.5 million. Is that necessary? Could you spend less?

Gareth Davies: Our lease is coming to an end, so we have got a prudent provision. At the time you exit every lease you have to put right any dilapidations and so on, so we have a prudent provision in there for that. We do not have an accurate figure yet because we have not completed that negotiation with the landlord, but we are planning to move out of our current office to a replacement office in Newcastle. The footprint will be a bit smaller, just to make more efficient use of the space in the way that we are doing in London, although that is dependent on our workforce plans, which we are still working on. It is possible, for example, that we look to have a larger team than we currently do based in Newcastle. That is one of the options, which Daniel described, that we are considering for the future. At the moment our plan is to have a smaller footprint, but a higher-quality office that will be carbon neutral by the end of the decade, which is our target for the whole organisation.

Daniel Lambauer: I would just add that the other reason for the £2.5 million is that there is an accounting standard change in 2023, which means we need to put it on our balance sheet. Usually we just expense it, so to speak, so the reason is an accounting change.

- Q49 **Chair:** The audit transformation programme is going to have an effect on the skills mix. The fact that many tasks that very young and inexperienced auditors need to do—what one might crudely call grunt work—will be done differently and in an automated way means that you have to, as it were, manage that skills transition. At the same time, you are going to have new graduate recruits into the NAO starting on day 1 with no experience at all of auditing. How are you going to ensure that they learn the old ways and the underlying philosophy that goes with that



while transitioning to a different way of doing things?

Gareth Davies: We have a very well-established graduate apprentice recruitment process and a very good training scheme, which delivers high-quality, qualified auditors at the end of it. We have good pass rates for the exams, and they are people with very marketable skills. We will continue with that. We will adapt it, as you described, to new standards and new technology.

Actually, new graduates arriving at the NAO will come with a lot of skills we do not have enough of. They may be data experts, and these new systems—which people like me who have been around a bit longer might find it quite a challenging training leap to get ready for—will be second nature to people who have been using such things their whole lives.

There is a change in the skills we need. We still need the same attributes of a good auditor. We need people who are curious, who can spot unusual patterns and who do not allow themselves to be fobbed off easily with unconvincing explanations. That skillset remains crucial, but we are going to have to upgrade all our skills in the NAO on digital operations. It does not mean we all have to become coding experts, but we need to understand how to use these tools effectively. I think the bigger challenge is for people who have been doing it the current way for many decades to actually open themselves up to a new way of using some of these tools. The youngsters coming in will be very quick to adapt, and there will be no shortage of basic auditing skills alongside their data knowledge.

Q50 Chair: Your strategic plan was written before the pandemic, and your strategy and estimate now outline that you intend to focus on long-term value for money, but at the same time you highlight in the strategy update that you are still dealing with the direct impact of the pandemic. Would it not be better for your resources to be directed towards the current, short-term crises?

Gareth Davies: That is a balance we have had to strike since it started, and I think we have done that well, actually. We have responded quickly and thoroughly to the pandemic risks, and we have continued progress on some of these bigger things. We have not released our focus on the big infrastructure projects. We have continued to supply PAC with reports on HS2, Crossrail and broadband roll-out—crucial areas for the whole country. We have started a new stream of long-term, value for money work on net zero, looking at how the Government are organising themselves to deliver both net-zero commitments and their broader environmental programme.

We are also continuing to focus on hard cost savings, so we have that blend alongside lessons-learned reports and good practice guides. That is why I paid tribute to the team earlier on, because to have delivered that mix, without being dragged entirely into the pandemic, means we have struck a good balance. Clearly, we are now in a different phase. We can adjust the balance. The pandemic work will be significant, but it won't be as dominant as it has been for the last two years, and that allows us to get



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into areas such as the levelling-up agenda, for example, working out exactly how that is playing out in terms of public spending. We have quite a lot to contribute on that front. It is always a question of getting the balance right, and I think the organisation has done a good job of that so far.

Chair: The Chair of the PAC wants to come in at this point.

- Q51 **Dame Meg Hillier:** One of the things that you have managed to extrapolate from some of the covid stuff is the wider lessons learned—for instance, about Government management of risk—which we as a Committee have been grateful for, but of course the challenge, as ever, is the impact that that has. How are these lessons landing with Whitehall? Are you at all confident that Whitehall will be willing to learn the lessons and actually implement them?

Gareth Davies: Obviously I am a sceptical auditor, but some extremely promising things have been happening alongside all the difficulties. In particular, the work we have done to concentrate our expertise in what we have called our hubs—on digital, on commercial and on risk management and financial management—has really helped us influence Government at the centre as well as in Departments. The work we did on, for example, managing digital change—the Committee held, I thought, a successful evidence session on this—allowed the Committee to use the examples of failures in individual projects, but to draw Government-wide lessons and to seek evidence from the people holding that function at the centre of Government to account. I thought it was a very productive session on what lessons they had learned from these examples and what they were doing differently as a result. There is a sign of progress on some of that. It's slow.

The problem with things like digital transformation when Government has legacy systems in every Department that are going to be very expensive to replace is that it cannot happen overnight. But having a clear view about the strategic barriers to good value for money, how they are being dismantled and what the pitfalls are to avoid has been, I think, a big step forward. There are signs of that happening on major projects as well. There is a lot of learning about unhelpful behaviours, like arriving at point estimates for the cost of giant projects far too early and then trying to stick to them when it was hopeless from the start, as opposed to using ranges in the way industry uses ranges when there isn't enough information to be precise.

Lots of these very practical bits of learning are now being applied consistently. There is a long way to go, but there are signs of hope on that.

Dame Fiona Reynolds: We have had some quite high-level discussions with some of the senior civil service around all of this to help us understand whether our work is landing in a way that helps you, as opposed to just telling the world that this went wrong or that went wrong. And actually we have had some very interesting reactions. I think the civil



service are exhausted, as indeed many institutions are at the moment, but they really do want to engage around these longer-term issues. In a way, short term/long term isn't a choice; we have to do both and we have to make the short term work for the long term. Many of the covid inquiries have in fact revealed really long-term structural, cultural and financial issues that will have to be dealt with in the longer term. There is a long way to go, but I have been really impressed by the leadership of the civil service, who really do want to embrace, in a very open way, the challenge. This whole period and our role in it have exposed some pretty difficult challenges, but there is an appetite to learn, I am sure.

- Q52 Sir Edward Leigh:** You say that you are asking for the resources to carry out your statutory functions and no more, but is there enough flexibility in the system? What happens if Parliament asks you to do something extra, different or whatever?

Gareth Davies: I hope that the dialogue that we have established with the Commission over the years is honest and transparent. If we thought that was something that we could accommodate within our existing resources by reprioritising, that is what I would say. If doing the job that was needed required new skills and more capacity, I would tell you that as well. I was honest with you this time last year that we needed a bit more to cope with the work that the pandemic was bringing our way, and also clear about when we think that will finish. I would do the same again. It depends on the situation. If we could accommodate it—my teams love rising to challenges, sometimes too much, but I would never ask them to do something that they were not properly resourced and equipped to do.

- Q53 Peter Grant:** In your estimate memorandum, you have used a particular phrase. You have said: "We...are professionalising our approach to knowledge management". Could you explain what that means in layperson's terms?

Gareth Davies: I have explained that we have new hubs, which have been the focal point for our specialist knowledge in those key areas. Having good people there is obviously a big part of the battle, but it is not the whole thing, so we have been working really hard on the machinery below the bonnet. If somebody learns something important from an audit committee meeting at a Department, how does that find its way into the NAO's knowledge rather than just stay in the head of the individual auditor who heard it? We have been connecting people with our hubs, so that they know who to talk to when an interesting or important development has come up and they know how to record it in our systems. We have a Sharepoint approach, which is still developing, but that is all about helping people know how to record something so that it is not just safe, but accessible to the rest of the organisation.

There is a lot of work taking place on dull but very important issues. This is our observation of other organisations, which underestimate the value of knowledge as an asset. It is not just about capturing it, but about being able to access it and use it. It is a long road, because everybody has to learn to use the systems in the same way so that they know where to find



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things, but we have made a good start. It is already improving our ability to do those things, and we have already had more examples of people making connections between what were apparently disparate bits of work. Actually, they were showing us something important if you combined them together. That is exactly what this is all about. It involves some system changes, some training and quite a lot of changing people's established ways of recording things. Typically, the more senior people are in the organisation, the bigger the job it is to get them to change their long-established habits. But it is a really important part of our programme.

- Q54 Peter Grant:** One of the issues that can sometimes arise is in sharing the right information between someone who is doing a value for money audit in an area and someone who has been involved in the financial statements audit, partly because some of the information that you will bring out in the financial statements audit will be confidential, for a number of reasons. How do you make sure that the person who needs that information knows where to find it? How do you make sure that the person who got the information—possibly in a different Department and on a different kind of audit, and possibly in Newcastle instead of London—knows who they should phone and say, “I think you should have a look at this”?

Gareth Davies: There are echoes of Dame Fiona's answer earlier, because a lot of this is culture. What is people's instinct in that situation? Rather than, “Well, I'm doing my job, so I can just get this bit done and I don't need to bother anybody else with it,” it should be, “I can tell that it's important that I make a connection with another team.” Culture is a big part of this, as are the systems that I was just talking about. We have a framework of integrated risk assessments for every departmental team—that is both value for money and financial audit—so part of our planning process each year is to update the integrated risk assessment in order to bring in and share the insights of people working on the accounts and our value for money work, so that we do not miss the kinds of points that you were describing. It is about culture and systems, but we also have a structured process for making sure that there is an organised conversation between our staff working on the same issue.

- Q55 Peter Grant:** How much of an obstacle to that whole process is it that we expect your staff to be seeing each other physically less often, either because they are working from home more often or possibly because you move to a bigger number of smaller offices, so that someone who is auditing one Department might never physically sit down and have a coffee with somebody who is auditing a different Department?

Gareth Davies: That is one of the reasons why we have been encouraging people to use the offices, because they have all sorts of purposes and that is a big part of it. Actually, the culture issue is bigger than just the physical environment. Although we expect people to be using the office a lot, the teams where they have really got this cracked do not allow the fact that they are in Newcastle and London to get in the way of sharing information. They do it really well.



Q56 Chair: How do they do it really well? What is the “it” that they do that is the difference between those that do and those that don’t?

Gareth Davies: They consider themselves a genuine team, rather than two separate ones who happen to be working on the same Department, and they understand what each other’s priorities are, which is not always the case. Rather than having their heads down and saying, “I’ve got to hit this deadline,” they understand what the rest of their team is working on in relation to that Department or issue.

Q57 Chair: What are the protocols they put in place? Do they have a morning meeting every morning at 9 o’clock—as it were, morning prayers—even if it is for only 10 minutes?

Gareth Davies: We don’t tell them what to do. We tell them what we expect them to achieve, and let them work it out for themselves. We have to do that because some of them are separated physically, being in two different offices, and some of them work together in one place. What we are aiming at is a strong culture on every team, even though that will play out in a different way, depending on how they are organised.

Daniel Lambauer: If I may say on the impact that is coming from the audit side myself, most teams have committee meetings, both sides, once a week, their management directors, management teams, the ones below the executive, all mixed. Mine does meet every week as a minimum, but that is the corporate services. There are fortnightly director forums, as well. A lot of sharing is happening. We have a lot of various methods and forums where our teams are sharing expertise.

Q58 Chair: I would like to ask about digitalisation because it is becoming central to everything in public services, particularly in the context of the pandemic. Does the audit work in that area require specific skills? How confident are you that the NAO has now the right skill sets for it?

Gareth Davies: We issued a Report with quite a rude comment about the digital skills at senior levels in the civil service. Obviously, as with all our Reports, we applied the medicine to ourselves. We still have work to do on the—ugly word—upskilling of digital skills for everybody in the organisation, including senior people.

That programme is under way for us. There is a combination of very technical digital skills in Daniel’s digital services team, where we need experts in that. As I said earlier, the generic audit skill range will include more data analytical skills than it used to, so there is that component. Then there is our digital hub, headed by a director, Yvonne Gallagher, who is a very experienced senior manager of digital services in other organisations, and has the confidence of her opposite numbers in Government Departments, to hold conversations about strategy and the kind of issues we were discussing earlier on dealing with legacy systems and so on.

So it is quite a range of implications for us as an organisation, from highly specialised and high-level to routine but different from before. Our entire



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learning and development programme—our training programme—is focused over the next couple of years on getting us ready for this new audit platform, which includes a lot of digital skills.

- Q59 **Chair:** Do you look at the didactic side of this? You mentioned earlier that younger people coming into the organisation feel much more natural about many of these skills, whereas older people don't. You have a mix in age range and skill sets across the organisation—something that many organisations field.

Digital exclusion is not only about poor people in rural areas with no broadband, but older people who might feel more afraid of this. We have seen lots of evidence of local councils working successfully with silver surfers, as they are often called. But with people who are still of working age in organisations, have you looked at how, didactically, you teach older people?

I know that 30 years ago, if you wanted to make a video machine work, you got the three-year-old and he or she made it work. Now, anybody under 20 or 25 can fix my phone, when I am stabbing at it hopelessly. There is a gap, depending on what you grew up with. How do you deal with that in a learning environment, to ensure that you don't exclude older people? Because you've still got lots of older people, who are very valuable, and you don't want to make them feel that they are behind the curve. How do you do that?

Gareth Davies: Often they are leading the work and need to be completely across how it is being done. So this is a big question for the training programme that I just mentioned, and we have a really effective learning and development team, who are in touch with developments in that field, on how learning is developing for these things, and using a range of techniques, as well.

Sometimes the material itself lends itself to a different way of delivering it; sometimes it's the learning style of the individual, and what they are comfortable with, as you say. So we have some typical classroom-type training, because some people learn well that way. We have videos. Take your example of, "How do you fix a phone?" Nowadays, most people just look at YouTube; there are videos that show you how to do anything practical. A lot of our people learn well from that kind of step-by-step video instruction. We have webinars, and do some training remotely and some in person. That is all built into the plan. We get feedback on each version, so that if one is working particularly well, we do more of it, and if something just is not working, we back off. That is the approach. We have a team that is very effective on that.

Daniel Lambauer: Let me briefly add that it is also a cultural point. We have run mandatory classroom-based training for all senior managers in the NAO on "digital for non-digital experts", so to speak. When I opened this training, I placed big emphasis on it being a cultural thing. It is basically saying, "You can't fail" and little things like "Don't delegate engagement with the systems to other people; try it yourself." It is always



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useful to do that, even if it is just doing your own Excel sheet now and again—that is okay. It is important nowadays to engage with the systems yourself and not just let junior colleagues do it. It is a lot about curiosity as a value and as part of our values. I think that our colleagues really appreciated that.

- Q60 **Peter Grant:** Mr Davies, I know that you have been working very hard to try to increase the number of Departments that get their accounts finalised and audited before the parliamentary summer recess. That has obviously been much more difficult during the pandemic. It is worth putting on the record that that is an accounts certification and publication process that is between three and four times quicker than equivalent-sized bodies in the private sector need to cope with; it is a significant demand not only on your own teams, but on the people doing the accounts in the Whitehall Departments.

The Commission has spent a lot of time looking at assurance of audit quality over the last year or two. It was one of the main subjects of the discussions that we had with your counterpart and our counterparts in the Scottish Parliament yesterday. How do you balance those two imperatives? How do you make sure that the audit is completed on time within the available budget, without running the risk that you lose the quality and, effectively, the entire point of the audit being done in the first place?

Gareth Davies: Getting your priorities right is crucial. All of the audit teams are clear that we will not sign off until we have sufficient and appropriate audit evidence. If that means missing a precious deadline, we will miss it rather than take a risk on inadequate evidence. It is that clear to everybody. There have been examples where we have had to do that and people have seen that we are serious about backing them up on that, because sometimes there is a very frustrated audit committee on the other side of the table who want to know why the deadline has not been hit. We will spell out why: because the organisation has not been able to provide the evidence that we need and we have been clear about what that is. That simple statement of priority is a big guard against the risk that you are describing.

The firms auditing the very largest companies actually deliver their audit opinions faster than we do. Listed companies will typically have a December year end and an audit opinion by the end of February. That is incredibly fast and these are very big, complex audits. We take learnings from that. It is all about how much assurance you can get before the year end, and then what you need to update in the short period between year end and opinion. But there is no compromise on quality. Yes, of course, audits need to be timely. You only have to see what is happening in local government audit in England at the moment to see how dangerous that can become, because there are some councils that are now two years out of date on their audit opinion, which is just unacceptable. Timeliness is important, but it can never override the need to have sufficient evidence.

- Q61 **Peter Grant:** This takes us back full circle to the questions I was asking



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at the beginning. Clearly, the fact that you have so many big Departments all landing their financial statements on you at the same time, all with the same target for completion, has to be a significant aggravating factor on the workload and the pressure on your staff. Are you satisfied that the public interest in operating in that way justifies the sometimes quite significant negative impact that it has on your staff, and probably on staff in Government Departments as well?

Gareth Davies: This process already works well in many Departments. Some Departments managed to have their accounts prepared for us to audit, and the audit completed, by the summer recess all the way through the pandemic. I would single out the Home Office as a good example. DWP, which was significantly affected by the universal credit surge, also managed to have audited accounts by the summer recess.

Yes, those teams worked very hard to achieve that, but the feedback from our staff in those teams is that they prefer having an intense, busy summer period followed by a proper break, rather than having the Forth bridge syndrome: audits dragging on over the summer, never quite feeling that it is okay to go on holiday—although we insist that they do—and coming back to find the work is still there to be finished. The Department of Health went all the way through to January; and then, at the end of January, that team was already behind on planning for next year. That is really stressful, and worse than the clear cycle of a peak period that everyone gets through, a celebration when they have achieved the audit, and a holiday. That is a much healthier way to work. That is the feedback that our teams give us as well. The challenge is in getting from where we are to there, because obviously some Departments have some catching-up to do.

Q62 **Chair:** What is the deciding factor that means that some Departments—you mentioned the Department for Work and Pensions—do it successfully and others do not? Is it the external environment that they face—although universal credit was a huge issue to have to deal with—or is it the management and leadership in those Departments, right up to and including the political level?

Gareth Davies: To be fair to all the other Departments, the challenge is not the same. DWP faced a big challenge, but it was about scaling up an existing, proven system. If you take the Department of Health as the obvious example, it had to do things that it had never done before. It had never had to be a PPE-procuring organisation, set up a massive testing programme or launch a gigantic, fast vaccine programme. We are not comparing like with like. It is no surprise that one found it much more difficult to complete the accounting process by the summer than the other.

Even taking into account the different challenges the Departments faced, the strength of the finance team and the resourcing of that team are factors. We have definitely fed back to Departments when we think they have been overstretched on resourcing in financial reporting activity. The engagement of both senior management and audit committee are also important to success. The Home Office faced the challenge a few years



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ago of pulling its timetable back to pre-recess, and it did that because everybody treated it as a priority in the Department. It did it very successfully, and has maintained that ever since. All those ingredients are important.

Chair: Peter Grant, I think you had not quite finished.

Peter Grant: Thank you, Chair. A wee bell rang in the back of my mind to tell me that I was so excited to ask my questions that I forgot to declare my interest at the start of the meeting. I am a qualified member of CIPFA. I apologise for that oversight.

Chair: Right, although it's already on the public record because you have declared it several times. Thank you for that.

Q63 **Anthony Browne:** I have a follow-up question about audit quality. You said that you would not allow a compromise of audit quality as a result of chasing deadlines and so on, but I wonder how you actually do that. I have experience from my career of auditors who did not perform very well bringing in new auditors. They checked the previous audit and gave us a whole register of problems. We went back to the original auditors, and they admitted that they did not have proper systems in place for assessing the quality of their own audit. Do you have independent teams that assess audits? How do you do that?

Gareth Davies: First of all, we follow the ethical standard on rotation of senior personnel. The big risk is familiarity. The NAO has to be the auditor; it is not a question of bringing in a different firm, and I will say a bit about that. We rotate the director and manager on the audit, though not at the same time. You are right: it is amazing how a fresh pair of eyes, even from the same organisation, can surface new issues.

Q64 **Anthony Browne:** How often do you rotate them?

Gareth Davies: Every five years, for the director. That is long enough to become very knowledgeable about the organisation, and to give a good-value audit, but at five years, you start to think, "I've looked at this thing five times now, and I am starting to lose the fresh perspective." Managing that rotation is an annual task. Obviously, we also have in mind people's career development, and the need to make sure that they are being stretched in new ways.

We also have an internal quality control framework. An increasingly large sample of our audits is reviewed by our internal quality checking team. They do both hot and cold reviews. The hot review is before you have signed off. That is designed to ensure that the risks have been covered adequately; it is then not too late to address any gaps. The cold review happens after the audit has all been done. It is a bit like what the FRC does with our work; we check how these audits stand up to the scrutiny of an independent team. We do a significant number of those each year. Then we have the FRC do an external inspection. We get a good coverage of audits in that way. That sometimes throws up thematic areas that we need to attend to, as I mentioned earlier with regard to financial



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instruments. Sometimes the issue is just the way that the team applied our methodology. Obviously, there is a learning loop in both cases.

- Q65 **Anthony Browne:** You mentioned that some local authorities have not had their audits completed for a couple of years; “unacceptable” was the word you used. South Cambridgeshire District Council in my constituency has not completed its audits for three years now—or certainly for a number of years. I would not expect you to comment on them in particular, but what are the problems that local authorities have with auditing and completing their audits?

Gareth Davies: The Government recognised that they had this problem almost two years ago and commissioned Sir Tony Redmond to review what was going on and make recommendations. He reported over a year ago. The Government are implementing the recommendations, except the one that he would regard as his key one. The system had become fragmented since the demise of the Audit Commission. I declare an interest: I used to work there. His suggestion was that a system leader was required to restore some direction and order. The Government did not agree with his proposal that a separate body be set up to do that, but they are now tasking the FRC with that role, which should help address the leadership deficit in the sector. There are significant challenges, including to do with the commercial attractiveness of that work compared to other things that firms are doing. I thought Sir Tony’s report was a good diagnosis of the issues.

- Q66 **Chair:** Could you write to us about the Government’s proposals to pursue this through the Financial Reporting Council? We would like to know more about that. Yesterday, in Scotland, we met our sister body, the Scottish Commission for Public Audit. There is also a body called the Scottish Accounts Commission, which did a job similar to the Audit Commission here. It does not really have any staff now, but it has a board and is a commissioner. If we are not to bring back the Audit Commission in its previous form—it had a large staff and did a lot of the audits itself, and commissioned out a lot to firms—there might be some merit in looking at a scheme that more closely copies what has resulted in Scotland. I would like to think more about that. If you have any thoughts on that that you would like to send us in writing, they would be very welcome.

Gareth Davies: Will do, yes.

- Q67 **Sir Edward Leigh:** A last question from me, on quality targets. You have a quality target of 100%. How realistic is that, given unknowns such as your audit transformation programme? What investment will you require to meet the 100% quality target?

Gareth Davies: I think it is the only credible target for us, but it does mean that there may be some years in which we do not hit it, and I will need to explain to you why that has happened and what we are doing about it. We started that process last November, which I thought was very helpful. Anything else would, I think, be the wrong level of ambition.



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Our investment is set out in the plan. Essentially, it is everything we are doing on people, quality, the audit transformation programme, the new software platform we discussed and the training programme, and for the past couple of years, we have been working to a quality plan that makes the point that this is a whole system operation. We have been using the analogy of aircraft safety: it is not acceptable for audits to go wrong, in the way that it is not acceptable for a plane to crash, so how does an airline manage that? It is through a safety culture where everything is designed to failsafe. Obviously, it is not 100% on all airlines every year, but it is very high. It is that kind of thinking.

This is not about going on a training course and learning a new technique. This is your mindset, and how you deal with pressures on your time. One of the reasons why we are so hot on excessive hours, as I was describing earlier, is that I know I do not make very good judgments when I am on hour 73 of the week, and I do not want my audit staff making crucial judgments when they are exhausted and at that stage of tiredness. We think about quality as a whole system. We have some very specific investments, such as the software, but it is the way we manage the organisation all the time that really makes the difference.

Q68 Chair: What you say about airline safety is fascinating, because comparisons have been made—papers have been written—comparing the way airline safety procedures work with the way software development works. The reason why there is much greater learning and far fewer failures in airline safety is because of the culture and the openness towards reporting when there are problems. Are you saying that that is essentially what you are trying to do in developing an auditing framework?

Gareth Davies: Yes, and I think it is the same point that Dame Fiona was making earlier. If people are feeling under undue pressure for any reason, whether it is pressure from the audited body, time pressure or just not wanting to look as though they have let the side down, we make it clear to them that telling us is the most important thing they can do.

Chair: That is a very optimistic note on which to end this session. This concludes today's evidence session. May I take this opportunity on behalf of the whole commission to thank you and your board, and indeed your whole staff at the National Audit Office, for everything you do—for your tremendous hard work and service to Parliament over what has been a very difficult past two years? The commission is very grateful to all of you. Thank you very much for coming along today; the commission will now deliberate in private.