Written evidence submitted by Professor David Heald

The Usefulness of the UK Whole of Government Accounts: Written Evidence to the Public Accounts Committee

Introduction

1. I welcome the opportunity to submit this memorandum to the Committee in response to its call for evidence (Committee of Public Accounts, 2023) ahead of its annual meeting with the Treasury about the UK Whole of Government Accounts (WGA). There are external parties, such as professional institutes, think tanks, civil society organisations, capital market actors and academics, with expertise on WGA which now have a channel through which they can contribute to Parliamentary scrutiny of this important annual document. It was unfortunate that the 2022 meeting (Committee of Public Accounts, 2022) was held two days after the publication on 6 June 2022 of WGA 2019-20 (Treasury, 2022), giving inadequate time for the Committee to prepare to consider such a long and complex document.
2. I commend the Treasury for its decision to publish WGA 2020-21 (Treasury, 2023b) before the summer 2023 Parliamentary recess even though this probably led to lower accounts quality and more audit qualifications. Clearing the decks was essential so that attention could turn to WGA 2021-22. Timeliness is vital, and delays of such length threaten the credibility of the WGA. Preparing the WGA is a massive undertaking which I believe the Treasury has never adequately resourced in relation to its scale and complexity.
3. For reasons outside the control of the Treasury staff responsible for its production, WGA 2020-21 was published 27 months after the reporting date of 31 March 2021. It is important to stress that, though Covid-19 complicated the production of WGA 2020-21, there were already signs that timeliness and accounts quality were deteriorating. This memorandum suggests reasons for this which the Committee might wish to explore with the Treasury. Delays would never be tolerated with the production of the government finances component of the national accounts, suggesting that, 25 years after the Treasury's decision (Treasury, 1998) to proceed with WGA, government financial reporting still does not have the centrality in Treasury thinking that is enjoyed by economic statistics.

4. I am organising my memorandum to follow the three topics on which the Committee asked for written evidence.

The impact of any delays to and missing data from the WGA

5. The credibility of the WGA, which I consider to be a vitally important document for transparency and accountability, is threatened by delays. When reporting began with the publication of WGA 2009-10 on 16 July 2013 it was already clear that the novelty and complexity of the WGA were bound to result in slow delivery. My view then and now is that what mattered was a pattern of gradually improving timeliness, but even before Covid-19 there had been setbacks. WGA 2014-15 was published on 26 May 2016, an audit lag of 13 completed months, the shortest ever. However, improvements then stalled. WGA 2018-19 was published on 21 July 2020 (15 completed months), even though disruptive public health measures due to Covid-19 were in force from March 2020. Subsequent years were badly affected by Covid-19: WGA 2019-20 took 26 completed months and WGA 2020-21 took 27 completed months. The reasons for the delays have been extensively discussed at previous meetings of the Committee, including the malfunctioning of the Treasury's public spending database (OSCAR II) which particularly affected WGA 2019-20.

6. Retrieving this situation, which marginalises WGA, will be difficult. Observing from outside, my view is that the Treasury compounded earlier difficulties by either not recognising, or not having influence over, the crisis in English local audit (Bradley et al, 2023a). It was not just that the Audit Commission had been abolished and District Audit disbanded, but also that what is now the Department for Levelling Up, Housing & Communities did not fill the vacuum. The abolition of mixed procurement for local audit services in England seemed attractive to the private audit firms until they appreciated how much risk had been transferred to them. These problems preceded Covid-19 but were accentuated by it. If some local audits are late, that constitutes a problem for those individual local authorities and their audit firms. If most local audits are late, there is reduced reputational risk for either local authorities or their audit firms. However, the fine levied on Mazars by the Financial Reporting Council (FRC, 2020) for the audit of an unnamed local authority's 2018-19 accounts created panic inside the private audit firms with local audit contracts, resulting, *inter alia*, in work duplication such as auditors appointing their own specialised experts rather than accepting the valuations of local authorities' own external specialised experts.

7. The UK Government rejected the central recommendation of the Redmond Review (2020) to establish the Office of Local Audit Regulation (OLAR), instead giving responsibility for local

audit to the proposed Audit Reporting and Governance Authority (ARGA). In the supposed absence of Parliamentary time for the ARGA legislation, responsibility now rests with the FRC until ARGA is established. The UK Government has further complicated the architecture in England by establishing the Office for Local Government to "provide authoritative and accessible data and analysis about the performance of local government and support its improvement" (Department for Levelling Up, Housing & Communities, 2023). What must be recognised is that the local audit crisis is restricted to England, strongly suggesting that its causes lie in the abolition in the early 2010s of the Audit Commission and of District Audit and in subsequent regulatory failures by central government in the context of a two-tier local government structure (Heald, 2023).

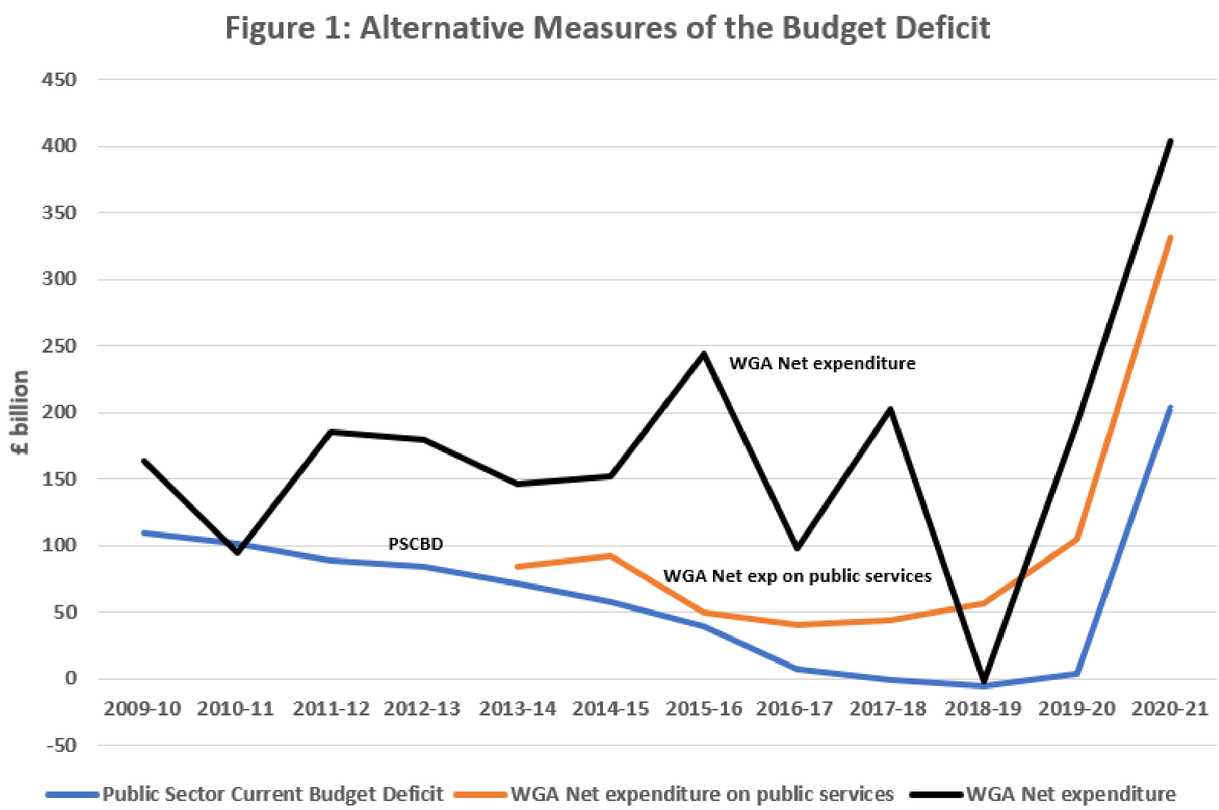
8. The Committee might usefully ask the Treasury for:
   a) data by nation and type of local authority analysing those councils which (i) only submitted draft accounts for WGA 2020-21 or (ii) did not submit any accounts for WGA 2020-21
   b) information on how many councils were required to have their WGA 2019-20 submissions to OSCAR II assured by their auditor. It is in the public domain that only 10 councils required auditor assurance for WGA 2020-21 returns after the threshold increased from £500 million to £2 billion. However, it is not in the public domain how many councils required auditor assurance for their WGA 2019-20 returns. There has been a dramatic increase in the number of councils for which either draft rather than audited accounts were included in WGA 2020-21 or which were excluded because no WGA return had been made. The Treasury presumably raised the threshold to ease the pressure on auditors. The Committee could usefully establish whether the effect of this threshold increase was to downgrade the importance of WGA returns in the minds of stressed reporting entity finance functions, and whether the threshold should be returned to its previous level or reduced further.

9. Resolving the problems of lateness requires understanding of whether the problem in English local authorities derives from (a) accounting requirements, (b) loss of financial management and reporting capacity in local authorities, or (c) problems in the audit market. One reason behind the Treasury's (2023a) consultation document on valuing non-investment assets was to reduce the alleged burden of using current values, though this change will now not be implemented. In my view the Treasury has been looking in the wrong place as the deterioration in local audit performance is attributable to reductions in local authority capacity (accountants do not attract priority during spending cuts) and to the malfunctioning of the English local audit market. The

evidence for this is that there is no local audit crisis in Scotland, Wales or Northern Ireland (Bradley et al., 2023a).

The impact on the public finances from the COVID-19 pandemic

10. One of the principal reasons why I emphasise fiscal sustainability is so that governments can respond to major crises, which are now more frequent. If deficits and debt are constrained in normal times, there will be fiscal space for emergency spending and/or tax reductions during crises. There is evidence that the UK is not fiscally sustainable in the long term (OBR, 2023), though this is politically ignored, and that there is a serious neglect of infrastructure, both in terms of acquisition and subsequent maintenance (National Infrastructure Commission, 2023).



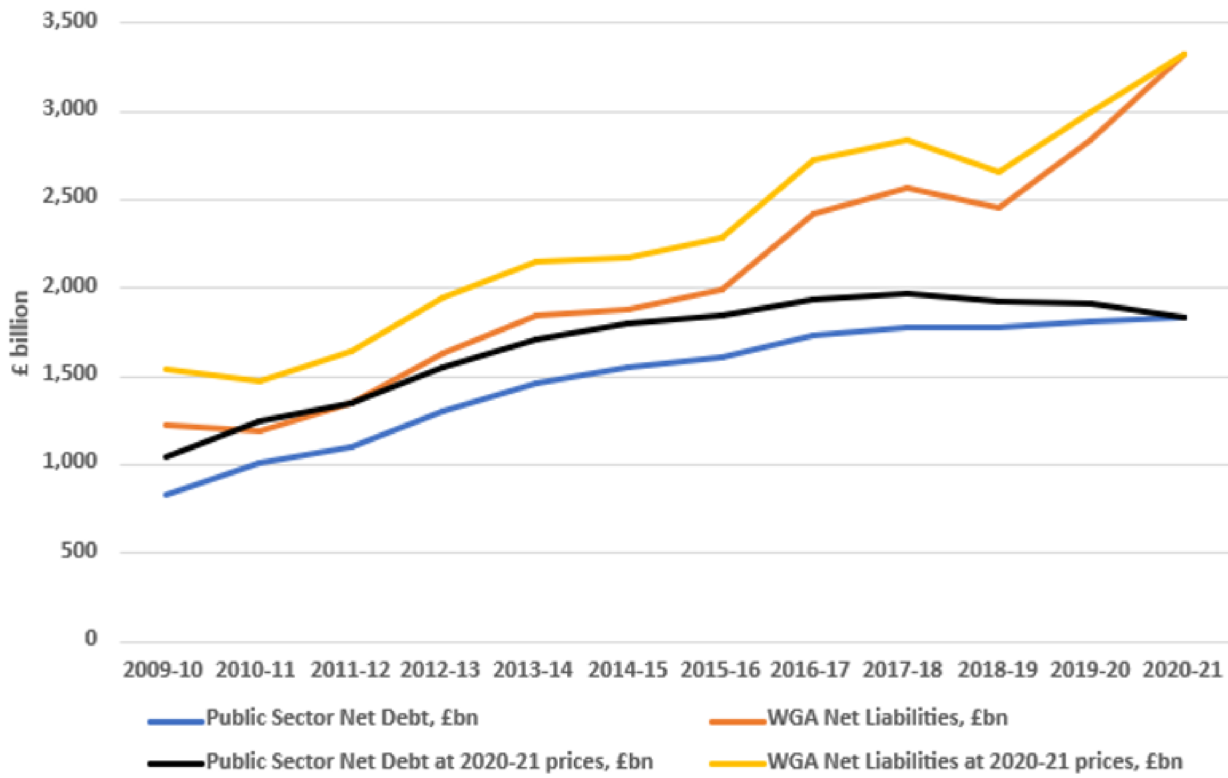
Source: Bradley et al. (2023b), derived from https://www.gov.uk/government/collections/whole-of-government-accounts

11. One of the valuable features of the WGA is that each year there are reconciliations between government financial reporting numbers (WGA) and national accounts. These reconciliations have a lot of information content, providing some answers but also raising questions that need probing. Making use of eleven years of audited WGAs (Bradley et al., 2023b), Figure 1 plots three lines, the blue line (lowest) being the Public Sector Current Budget Deficit (PSCBD) (national accounts measure based on ESA10). Until 2018-19 this slowly fell throughout the

period from 2009-10, increasing slightly in 2019-20 but then dramatically in the first Covid-19 year of 2020-21. The black line (highest) plots WGA Net expenditure (government financial reporting measure based on modified IFRS). In all but one year (2010-11) this is higher than PSCBD, but what is striking is the jagged pattern. From 2013-14 there are data available for the Treasury's new measure of WGA Net expenditure on public services (which excludes financial valuation effects). This orange line (middle) has a relatively flat trajectory but deviates upwards from PSCBD from 2016-17 whereas PSCBD had been stabilised relatively close to balance. Unsurprisingly all three measures explode during Covid-19 but what is arguably more interesting is that increases in the two WGA measures of fiscal deficit started earlier. The WGA deficit measures are more adverse than the national accounts measure. In terms of policy making and scrutiny, the usefulness of the WGA measures is damaged by the lack of timeliness and by lower accounts quality.

12. My view is that the greatest potential benefit of the WGA is the generation of better information on the public sector balance sheet on a modified IFRS basis which has then stimulated initiatives by the Office for National Statistics to improve public sector balance sheet data on a national accounts basis. Figure 2 plots Public Sector Net Debt (PSND) in nominal terms (blue) and real terms (black) at 2020-21 prices, while WGA Net Liabilities are plotted in nominal terms (orange) and real terms (yellow). WGA Net Liabilities are always higher than PSND. As with the deficit figures, the WGA measure is more adverse than the national accounts measure. This should heighten Parliamentary concern about the UK's fiscal unsustainability.

Figure 2: PSND and WGA Net Liabilities in nominal and real terms



Source: Bradley et al, (2023b), derived from https://www.gov.uk/government/collections/whole-of-government-accounts

13. I am encouraged by the Treasury's use of WGA data in its Balance Sheet Review (Treasury, 2020), but I issue a word of caution. The UK public sector is large and complex, consisting of more than 10,000 entities, some of which have separate democratic accountability and some of which have statutory independence or constitutional protection. The distinction between core and non-core assets can be useful in thinking about what the public sector might look like in future. However, there are dangers that independence might be trodden on by central government searching for revenue from asset sales without regard to whether entity managers regard those assets as core.

Progress on implementing recommendations from the Committee's 2019-20 WGA report

14. I will leave it to others, most likely the Treasury and the National Audit Office, to report on what progress has been made in responding to the recommendations in Committee of Public Accounts (2022). The depth of the Committee's concerns is captured in the following quotation from its report on WGA 2019-20:

> …. the Treasury's data is increasingly incomplete and unreliable, with the WGA including unreliable data for 29 unaudited Local Authorities and excluding 23 Local Authorities altogether. This has reduced the quality of data used to oversee the Local Government sector and to prepare the WGA, and reduces the certainty of any consequent insights, conclusions or decisions. … The

Treasury has raised the component audit threshold for the 2020–21 WGA, such that just 10 Local Government returns will require auditing for 2020–21. Although this will make it easier for the Treasury to produce the WGA on time, it may have negative consequences for the quality and reliability of data unless the Treasury undertake additional assurance work to mitigate this risk (Committee of Public Accounts, 2022, para 3).

This assessment by the Committee has implications for fiscal statistics that make use of financial reports. The situation in WGA 2020-21 was much worse.

15. I believe that the Treasury will need the support of the Committee and of Parliament to reverse the pattern of lateness and decreasing accounts quality. The Treasury staff who prepare the WGA have been operating under impossible conditions, most recently emanating from Covid-19 and the English local audit crisis. It is vital that the Committee reasserts its support for the WGA and counters any suggestions that the WGA should be de-prioritised, paused or abandoned. Although it is difficult for the Treasury to acknowledge this, much of the current problem derives from English local government (declining financial capacity in local authorities and the local audit crisis) and the failure to either implement the Redmond Review (2020) proposal of OLAR or to bring forward legislation establishing ARGA. The problem is not over-complicated accounting (the affairs of public entities are complex and WGA was slowly improving in timeliness) but mainly around resourcing and local audit in England.

16. Although the Performance Report in WGA 2020-21 contains much useful information, its fluency is damaged by much text having clearly been written by different hands across central government. That is a price I am willing to have paid for publishing before the 2023 summer recess, rather than create doubts about the future of the WGA. I recognise that such commentary is difficult to write when the publication of audited accounts is 27 months after the reporting date. A considerable amount of text related to 2021-22. How to handle post-balance sheet events when the audit lag is so long is inevitably a problem, particularly when there have been dramatic events such as Covid-19. The Treasury should be encouraged to address these issues when WGA 2021-22 is published in order to secure more coherence.

17. I have one technical query which I hope that the Committee will raise with the Treasury, either at its 9 November 2023 meeting or through correspondence that later goes into the public domain. In the reconciliation between PSND and WGA Net expenditure in WGA 2020-21 (Treasury, 2023, p. 274), the item for ‘Asset Purchase Facility Fund’ (negative £1,557 billion) is dramatically higher than in previous years and the item for ‘Other adjustments including eliminations’ (positive £1,663 billion) is dramatically higher than in previous years. What is not clear is whether there have been large changes in underlying substance or whether the reporting

is being done differently in WGA 2020-21. For example, are these items connected so there are partial offsets in the reconciliation, and is the positive £1,663 billion connected to the much higher use of draft accounts and to the higher level of exclusions?

Conclusion

18. I believe that the WGA is a valuable innovation in UK public sector financial reporting, notwithstanding the current problems of lack of timeliness and deteriorating accounts quality. In future years when the WGA is again published before the summer parliamentary recess, I hope that the Committee will continue this year's practice of inviting external contributions before its oral evidence session with the Treasury.

19. The Committee might engage with the Treasury on what requires to be done to resolve the underlying causes of WGA delay and to consider what the policy response should be. In WGA 2020–21, 155 entities were not consolidated and 120 consolidated using draft accounts, both far higher than in earlier years. The Treasury does not know why so many entities did not submit their WGA 2020–21 returns before the deadline (Comptroller and Auditor General, 2023, para. 5 on p. 262), though I have suggested reasons for this in paragraphs 6 and 8(b) above. Indeed, I have always believed that one of the benefits of the WGA was that its existence had created useful pressure for faster entity reporting. It is already clear that WGA 2021-22 and WGA 2022-23 production will face formidable difficulties. Public Sector Audit Appointments (2023), whose remit relates to England, has reported that:

    Local government bodies are required to publish accounts with an auditor's certificate or opinion by 30 September or to explain the reasons for non-publication. At the publishing date of 30 September 2023, only 5 out of 467 local government bodies' 2022/23 audit opinions have been given. This adds to the 456 that are outstanding from previous years.

    This update, which probably includes bodies outside the WGA consolidation because of their small size, demonstrates how the situation has continued to deteriorate.

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