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## Introduction

Auditing is a necessary but often unpopular activity in modern society. Grudgingly, most of us accept the intellectual case for auditing, though we do not always welcome the auditor's attention to our own affairs. Nevertheless, most of us are re-assured when the 'watchdog barks', in cases where accounts are revealed as defective; fraud is detected; and waste in public programmes is brought out for all to see.

Yet many of us wonder whether the expense of auditing is justified by the results achieved. This is true in both the private and the public sectors. And so far as the public sector is concerned, many of us wonder why the same mistakes seem to be made time and time again – projects delayed; estimates exceeded; public services disappointing.

So the question arises: 'Public Service Auditing – Is it Value for Money?'

And the purpose of this book is to show that it can be value for money. The argument is that:

- Public authorities are fundamentally bureaucracies – hierarchies operating by rules – and hence are more inclined to look inwards to processes and procedures, than outwards to results and outcomes for those whom they have the duty to serve.
- Traditionally, public sector audit, valuable as it could be, through its independence from organisations, and the authority and objectivity this bestows, reinforced the tendency to look inwards by its concentration on seeing that rules and procedures were obeyed and money spent according to them.
- Auditors therefore concentrated on the cataloguing of failure, from which, of course, we may learn what not to do. But valuable as this is, especially in the detection of fraud and waste, an inventory of failures is not a guide to success.
- And the argument of this book is that by analysing and encouraging the successes of public administration, the auditor can act as coach and mentor rather than critic and nark; and his recommendations can

thus help his public sector clients to succeed in the future rather than simply criticising them for failure in the past.

### 1.1 MODERN PUBLIC ADMINISTRATION

As background to the argument, it may be helpful in this introduction to sketch out some of the main features of contemporary public administration, to set the stage upon which the auditor has to perform, and then to indicate how my argument is developed in the ensuing chapters.

It must be recognised that different states organise their governments and public administrations in different ways. The United Kingdom (UK), China, Portugal, Ireland and Greece are unitary states while others such as Russia, India, the United States of America (USA) and Germany are federal states. Others, notably Denmark, Finland and Sweden, have devolved considerable responsibility for delivery of public services to municipalities. Public services in many European countries have evolved and adapted in response to key historical events such as the need to marshal resources to fight two world wars; and all countries claim to share the moral imperative of tackling poverty and social exclusion and improving general human well being.

Political ideology has shaped public administration in many countries. For several decades after the second world war, many countries throughout the world extended the scope and scale of government activity. Industries were nationalised; national health services inaugurated; schemes of social welfare extended. Communist countries sought to bring most economic activities under state control, but many countries which maintained a social market economy, like the UK and France, nevertheless had a substantial state sector, with public enterprise providing many activities such as electricity, water, gas and railways.

From the 1970s, however, the emphasis changed. In many countries, including former Communist countries, the state was rolled back. Many economic activities were returned to the private sector. In the UK, for example, railways, electricity, water supply, the state airline, and telecommunications were privatised – though where state monopolies were turned into private monopolies or oligopolies, regulators were set up to ensure ‘fair play’ between shareholders and customers.

More recently, rapid advances in technology have been a major driver of change in public service delivery. What public authorities seek to influence has also changed in many countries. Whereas in the past

authorities largely made their own assumptions about services to be provided, they now increasingly seek to influence what might be called 'life style choices' in aspects as diverse as anti social behaviour, diet to prevent or reduce obesity, parenting skills and attitudes towards environmental sustainability.

What has emerged from these influences in many countries is a public sector which no longer has a monopoly on delivery. Increasingly, the private and voluntary sectors play important roles. In other respects, however, public services remain remarkably unchanged. Well defined, often elaborate, processes for decision making remain. Entitlement to most forms of state support, such as welfare benefits, or grants to promote economic development depend on meeting a complex range of rules and regulations. This inherent complexity increases the risk of exclusion, with significant numbers of people intended to benefit not doing so, as well as increasing the potential for administrative inefficiency at significant cost and acting as a disincentive for innovation and entrepreneurship. Many of the inherent tensions which successive governments have grappled with remain such as achieving the optimum balance in driving change by top-down targets or by creating markets and competition, or resolving the tension between central strategies and systems on one hand and delegation of decision-making to the front line on the other.

And herein lies the paradox. In spite of well meaning attempts to reform and improve the public sector, often, as in the UK with significant growth in expenditure on health, education and social welfare, there remains a widespread belief that services are not as good as they ought to, and could, be. In some areas, such as the need to tackle skill gaps and improve productivity, underperformance has consequences for national competitiveness in a global economy. This is, of course, not the complete picture. Most of us would accept that the average standard of living in most countries – though sadly not all – has improved and that as well as economic prosperity, public services such as health and education have contributed to this. Yet there remain significant examples of waste, underperformance, and of citizens, particularly those who are the most vulnerable in society, not receiving the service to which they are entitled to or expect. Much research into why this is the case exists. But reaching consensus around how best to design and deliver public services which meet most people's reasonable expectations and which are affordable and cost effective continues to elude us. And it is here that public audit enters the debate.

## 1.2 THE TRADITIONS OF STATE AUDIT

State audit has existed in some form in nearly all countries – autocracies as well as democracies – for several hundred years. And, indeed, accountability for the use of public funds is a cornerstone of democratic government. The arrangements for public sector audit take different forms throughout the world, though there is scarcely a country which does not have an Auditor General or Court of Audit under one name or another.<sup>1</sup> Within this variety two broad traditions may be distinguished. The first is a common law tradition, as seen in countries of the British Commonwealth, the USA, and some Scandinavian countries, where the main emphasis is upon the auditor general's responsibility to report his findings to the legislature who will then decide what recommendations to make to the government. But the auditor general has no legal powers to punish the transgressions distinguished in his report.

The second tradition is what might be called a Roman law tradition. Here public sector audit is conducted by a court, which can hold hearings, and whose decisions and punishments have legal force. Examples include the Cour des Comptes of France, the Corte de Conti in Italy and the Tribunal de Cuentas in Spain.

In more recent times a number of countries have introduced significant changes to the remit and operation of their state audit offices. A common objective has been to give statutory authority to carry out performance or value for money audits. In Italy for example, major new audit legislation was enacted in 1994 that enhanced the role of the Corte de Conti and facilitated the development of performance audit. In Ireland, the Comptroller and Auditor General (Amendment) Act was passed in 1993, extending the post's remit and placing performance audit on a statutory footing.

In the UK the most significant enhancement of the status of the Comptroller and Auditor General was the National Audit Act 1983. The Act followed increasing parliamentary, academic,<sup>2</sup> and general concern about the influence that the executive, in particular the Treasury, the UK's Ministry of Finance, retained over the resources available to it, as well as the access rights of public audit; together with the oddity that the Comptroller and Auditor General audited the Treasury, while the Treasury audited the Comptroller and Auditor General – a conflict of interest

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<sup>1</sup> Comptroller and Auditor General (2005) *State Audit in the European Union*.

<sup>2</sup> Normanton, E. L. (1966) *The Accountability and Audit of Government* Manchester University Press.

indeed! Under the terms of the 1983 Act the Comptroller and Audit General formally became an Officer of the House of Commons, emphasising his independence from the executive. And the National Audit Office (NAO) was funded directly by Parliament, not by the executive, as the audit office had previously been. Express powers were given to the post holder to carry out examinations of the economy, efficiency and effectiveness with which central government departments and certain other public bodies had used their resources.<sup>3</sup>

As a result of the Act, and the UK Parliament's support, this value for money work became quickly established. Sixty reports are currently published and presented to Parliament each year. Since the 1983 National Audit Act over one thousand reports covering the full range of government activity have been produced. Assessing value for money requires a rigorous process which commands confidence, particularly of those intended to act in response to findings and recommendations – important if public audit is to have sustainable beneficial impact. **Box 1.1** summarises the generic principles of value for money work and how it is typically conducted. The Appendix to this book provides some account of the wide range of diagnostic and analytical techniques needed. While the Comptroller and Auditor General's remit excludes questioning government policy, the programme of value for money work and other traditional audit activity, particularly the financial audit of the accounts of government departments, provides considerable insight into both success and failure in the implementation and administration of public services and the underlying causes. The NAO value for money studies also increasingly draw on the experience of the private and voluntary sectors and of other countries. This enhances the perspective and insights they can provide and means that the argument and lessons presented in this book have relevance to public auditing generally.

**Box 1.1: What is meant by a value for money examination?**

1. A value for money study, evaluation or critique is about forming an objective assessment about whether a programme, project or activity is designed to, or has achieved, the best use of resources to

<sup>3</sup> The audit of local government in England is the responsibility of the Audit Commission. The audit of local authorities in other parts of the UK is the responsibility of the auditor generals of these jurisdictions.

- optimise costs and benefits (outputs, outcomes, quality of service and increasingly issues of equity).
2. Value for money studies typically follow a structure of diagnosis – what is the issue, e.g. under performance or scope for doing things better to arrive at a hypothesis; the second stage is analysing the underlying data – both quantitative and qualitative to test the hypothesis; the final stage is synthesis, where the data derived from the analysis is triangulated to arrive at well founded conclusions to derive practical recommendations for improvement.
  3. As with any major activity it is important that a value for money examination follows principles of good project management. In the UK National Audit Office the approach is:
    - To develop a business case justifying the examination, the issues it will address, the evidence it will collect and how this will be analysed together with a budget and time line for completing the study.
    - Fieldwork stage to complete the analysis, derive conclusions about value for money achieved, and/or potential to do so and formulate recommendations.
    - Give opportunity for departments, agencies or other stakeholders to comment on the findings, interpretation and presentation of evidence and conclusions – but the Auditor General retains ultimate responsibility for his conclusions and right to report to Parliament.
    - Publication

*Source: UK National Audit Office – Value for Money Handbook – a guide for building quality into VFM examinations - <http://www.nao.org.uk/>.*

### 1.3 THE CONTENTS AND ARGUMENT OF THIS BOOK

A wide body of evidence forms the basis of this book and its analysis of why public services are not as good as they might be and, most importantly, how performance could be improved. Regardless of whether it is founded in the Roman or Common Law tradition, public audit has considerable potential to support and encourage continuous improvement for the benefit of citizens both as consumers of services and as taxpayers. To realise this potential does require careful consideration,

and the book discusses what is needed if public audit is to be effective and, itself, deliver value for money.

Chapter 2 explores the way in which bureaucratic processes hamper the achievement of the goals of public services. To the extent that bureaucracy represents orderly administration and promotes equity and impartiality it has many achievements. But these have come at a heavy price, and this chapter explores why this is so.

The third chapter deals with the successes and failures of traditional public sector audit. Certainly, the preparation and audit of accounts and other documents gives valuable information about where money has come from and what it has been spent upon. It has been – and still is – a bulwark against fraud and theft. But it does not tell whether value for money spent has been achieved.

Many governments have sought to use such techniques as cost benefit analysis to answer this question. They take us so far, but they rest upon the contested ability to estimate individual and collective preferences in order to calculate the social costs and benefits of government activities over time. The strengths and weaknesses of these approaches and of their audit are also explored in Chapter 3.

Public servants' behaviour is key to better outcomes because they take the critical decisions, subject to their responsibility to politicians, determining the design, delivery and resourcing of public services. Influencing bureaucrats' behaviour, like all human behaviour is inherently complex. The source and quality of information on which policy decisions are made, how performance is measured and acted upon, and the current status of public opinion are just some determinants. The impact of audit, and in particular its potential to be a force for good, should not, however, be understated.

Chapter 4 examines why the recommendations stemming from the audit of cost-benefit and cost-effectiveness approaches are often accepted by governments but frequently fail to change public servants' behaviour. The key to this paradox lies in the public sector audit's traditional focus on failure rather than on the conditions of success. While audit is about exposing under performance and waste, this by itself alone will not encourage learning and an enthusiasm to do better. Basic psychology tells us that people are most likely to learn from success rather than failure. Criticism needs therefore to be constructive and explained and presented in a way that has coherence and meaning to those who need to improve. Doing so requires auditors to have an understanding of human behaviour – a skill not typically associated with the audit profession.



Disenchantment with traditional forms of bureaucracy led to experimentation in other ways of delivering public services. The most prominent of these and the most widely replicated internationally are privatisation and public private partnerships. The next two chapters – 5 and 6 – explore the rationale and implications of these two alternatives to bureaucracy and the impact they are having on accepted notions about the form which public services should take. Public audit in the UK through its traditional role of holding to account for the use of public money has charted the development of these two models of delivery, highlighting what works and, in particular, what is needed for success, as well as highlighting risks that must be managed. Privatisation and public private partnerships have also required public auditors to revisit their methodological approaches to assess value for money and draw on new skills. The implications of this for the public auditor have been far reaching.

Chapter 7 deals with the deleterious consequences of bureaucracies' propensity to spawn more and more rules and regulations. It examines the reasons for this and provides guidance for the auditor's examination of what recommendations can be made to curb and eliminate regulations that generate high transaction costs for their introduction and management; costs that may well outweigh any positive results that they may achieve.

Chapter 8 is concerned with the audit of the quality of public services for the citizen. Regardless of the method of delivery, the ultimate aim of all public services is to meet the reasonable needs of citizens economically and efficiently. In today's society, with its myriad of expectations, bureaucracies with their natural tendency to provide little choice and assume an undifferentiated homogeneous customer base are ill suited to deliver what most people want. The last thirty years has witnessed attempts to both fine tune and radically restructure traditional ways of delivering public services. Increasingly, the private and voluntary sectors are involved in delivery and the internet is transforming public services in ways never thought of before. These major developments have both influenced and are influenced by traditional bureaucratic models of working. This has given rise to tensions that have to be managed, for example, in terms of the balance between central determination of quality standards and discretion to design services that reflect local needs, as well as consequences for value for money. The third component of value for money – effectiveness – is now interpreted more widely to include not only assessing the achievement of desired outputs



and outcomes but also evaluating the quality of public services, social inclusion particularly in a multi cultural society; and equity in ensuring access to services. This development is largely influenced by the recognition that value for money must be interpreted as much through the eyes of those who depend on public services as those who design and deliver them. The implications of this for how public audit forms judgements about the quality of public services is the focus of Chapter 8.

The last four chapters consider what might be termed the ‘tools’ needed to make best use of public money and translate it into high quality services. Chapter 9 explores the meaning and relevance of risk management in the public sector and illustrates that rather than being risk adverse – the widely held perception – bureaucracies are more likely to be risk ignorant with significant consequences. Chapter 10 focuses on the importance of high standards to prevent fraud and impropriety and how in a changing public sector with multiple players this remains critical, if increasingly complex. Chapter 11 considers the application of project and programme management. Chapter 12 deals with the practicalities of measuring performance in a way which promotes rather than inhibits better delivery. Chapter 13 considers how the external auditor should organise his or her affairs if they are to combat bureaucracy effectively.

Finally, Chapter 14 pulls together and rounds off the book’s argument and explores the likely implications for external audit as the nature of public service delivery continues to evolve. And the Appendix sets out methodologies used by the UK NAO in undertaking its value for money studies.

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