



Cynulliad Cenedlaethol Cymru **The National Assembly for Wales**

Y Pwyllgor Cyfrifon Cyhoeddus **The Public Accounts Committee**

Dydd Mawrth, 2 Hydref 2012
Tuesday, 2 October 2012

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Cynnig o dan Reol Sefydlog Rhif 17.42 i Benderfynu Gwahardd y Cyhoedd o'r Cyfarfod
Motion under Standing Order No. 17.42 to Resolve to Exclude the Public from the Meeting

Cofnodir y trafodion yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir
trawsgriafiad o'r cyfieithu ar y pryd.

The proceedings are recorded in the language in which they were spoken in the committee. In
addition, a transcription of the simultaneous interpretation is included.

Aelodau'r pwyllgor yn bresennol **Committee members in attendance**

Mohammad Asghar	Ceidwadwyr Cymreig Welsh Conservatives
Mike Hedges	Llafur Labour

Darren Millar	Ceidwadwyr Cymreig (Cadeirydd y Pwyllgor) Welsh Conservatives (Committee Chair)
Julie Morgan	Llafur Labour
Gwyn R. Price	Llafur Labour
Jenny Rathbone	Llafur Labour
Aled Roberts	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats
Lindsay Whittle	Plaid Cymru The Party of Wales

**Eraill yn bresennol
Others in attendance**

Ann-Marie Harkin	Swyddfa Archwilio Cymru Wales Audit Office
Terry Jones	Rheolwr Technegol Technical Manager
Huw Vaughan Thomas	Archwilydd Cyffredinol Cymru Auditor General for Wales
Kevin Thomas	Archwilydd Cyffredinol Cynorthwyol Assistant Auditor General

**Swyddogion Cynulliad Cenedlaethol Cymru yn bresennol
National Assembly for Wales officials in attendance**

Dan Collier	Dirprwy Glerc Deputy Clerk
Joanest Jackson	Uwch-gynghorydd Gyfreithiol Senior Legal Adviser
Tom Jackson	Clerc Clerk

*Dechreuodd y cyfarfod am 9.28 a.m.
The meeting began at 9.28 a.m.*

**Cyflwyniad, Ymddiheuriadau a Dirprwyon
Introductions, Apologies and Substitutions**

[1] **Darren Millar:** Good morning everyone and welcome to today's meeting of the Public Accounts Committee. I remind everybody of the housekeeping rules. I ask that all Members and witnesses attending the meeting ensure that their mobile phones and pagers are switched off because they can interfere with the broadcasting and amplification equipment. The National Assembly for Wales is a bilingual institution and Members and witnesses should feel free to use either English or Welsh as they choose; headsets are available for amplification and translation. In the event of an emergency, we should all follow the direction of the ushers calmly in order to get us to a safe exit. We have not received any apologies for today's meeting, so we will go straight on to item 2 on our agenda.

9.30 a.m.

**Adroddiad Blynyddol a Chyfrifon Archwilydd Cyffredinol Cymru 2011-12
Auditor General for Wales's Annual Report and Accounts 2011-12**

[2] **Darren Millar:** I welcome the Auditor General for Wales to the table this morning, and also Kevin Thomas, the assistant auditor general for Wales, Ann-Marie Harkin, the group director at the Wales Audit Office, and Terry Jones, technical manager at the Wales Audit Office. Auditor general, do you want to make any opening remarks related to your accounts?

[3] **Mr H. Thomas:** I will try to keep these brief. There are a few things. One is to note that this is the first set of accounts for which I have been responsible. The previous one was half mine. Secondly, they show a reasonably healthy position at the Wales Audit Office and they are unqualified in terms of the external audit opinion. There are a couple of points about procedure that we need to bear in mind, given that we are considering legislation. The accounts are incredibly complex, largely due to the current arrangement whereby I have to keep separate the funds for local authorities. One of the points that we did not cover when I gave evidence on the legislation is that, under the intended legislation, that is abolished so that we are then able to deal with one set of accounts instead of having to divide them up into rather technical arrangements.

[4] Secondly, in terms of your consideration of these accounts, we need to improve the arrangements whereby, as you know, the chair of our audit and risk management committee delivers you an annual report on my accounts. That is not being considered by the audit and risk management committee until this afternoon and yet you are considering my accounts this morning. We need to, in a sense, dovetail those. Sitting right at the back is Deep Sagar, who is now the chair of the shadow board of the Wales Audit Office. So, we need to get the internal governance and your scrutiny of my accounts into order.

[5] That apart, there are two main points that I wish to draw attention to in the accounts. First, on the financial outturn, we have delivered more work this year than we had originally budgeted for, hence some of the figures that you see in the accounts. I am happy to talk further about those components. It was a wholly unique concatenation of issues that led to that position.

[6] Second is the issue of tax and VAT liabilities for which we made provision of around £2.6 million. We have been able to make this out of our own funds this year; otherwise, we might have had to seek your approval of a supplementary estimate to match that. However, unfortunately, the HM Revenue and Customs saga, particularly on VAT, is not yet complete. We have brought along Terry Jones, our VAT expert, if you wish to pursue these avenues and find out the exact current position.

[7] On the other HMRC side, we have, at last, a meeting set up with HMRC in which it will go through the various items of tax issues. I hope that, by then, we will have drawn a line under all of the inherited issues, many of which date back to before the Wales Audit Office was formed. So, that is the background. However, what I set out in this is a quite unique set of achievements by the Wales Audit Office and that is against a background in which we have continued to reduce our running costs. When we come to talk about the estimates in a couple of weeks' time, you will see that we have continued to drive down the underlying cost of the office and, at the same time, that is against a reduced audit fee to the audited bodies. With that, I await your questions.

[8] **Darren Millar:** Thank you for that and for raising the issue of the chair's report from the audit and risk management committee. It is important that we align these things in the future. We would welcome the opportunity to do that at a future date.

[9] You have provided us with a letter that gives us a little more detail on some of the issues that you no doubt expected us to raise questions on, so we are very grateful for that. In that letter, you say that your office had a surplus of £648,000 in 2011-12, but your audited accounts record a net comprehensive expenditure of £4.8 million. What is the difference?

[10] **Ms Harkin:** The surplus would be the amount at which, in a normal set of accounts, income would exceed expenditure. What we have to do is account in a particular way, which means that you draw a bottom line of net comprehensive expenditure to show all of your expenditure and then you show your funding from the Welsh consolidated fund. So, it is just presentational. If you look at the summary of financial outturn, that shows the surplus figure to which you referred; that is on page 49, on financial outcomes. That is probably the most easily understood table for a non-accountant. You will see the £648,000 there, at the bottom, as being the overall surplus generated in the year.

[11] **Darren Millar:** Thank you for that. So it is to do with the Welsh consolidated fund, effectively—the draw-down?

[12] **Ms Harkin:** It is just the way that we have to account.

[13] **Darren Millar:** Okay. Gwyn Price has the next questions.

[14] **Gwyn R. Price:** Can you explain why, while operating a surplus, the statement of financial position of the WAO has deteriorated from £162,000 net assets, to a net liability of over £1.2 million during 2011-12?

[15] **Ms Harkin:** It is primarily because of the rather large provisions to which we have already referred that we have had to account for in this financial year. If you look at the statement of financial position on page 77, what we have is net current liabilities—assets less liabilities—being, effectively, in a deficit position; our liabilities, on the surface of things, are actually greater than our assets.

[16] **Mr H. Thomas:** This goes back to the warnings that I and my predecessors had given that, at the point at which we settle the VAT, there would be a need for a supplementary estimate, where clearly we have put aside a provision. That provision, if it was called in full, would require us to come to talk to you about a supplementary estimate. However, I hope that it does not come to that.

[17] **Darren Millar:** Aled Roberts has the next questions.

[18] **Aled Roberts:** O ran treth ar werth, rydych wedi dweud eisoes fod darpariaeth o £2.4 miliwn yn y cyfrifon, ac mae sôn am hynny yn y llythyr dyddiedig 26 Medi. Pa mor debygol yw hi y bydd y £2.4 miliwn yn cael ei dalu? A ydych yn ymwybodol o'r sefyllfa ar hyn o bryd? **Aled Roberts:** On value added tax, you have already said that there is provision of £2.4 million in the accounts, and there is mention made of that in the letter dated 26 September. How likely is it that the £2.4 million will be paid? Are you aware of the situation as it stands?

[19] **Mr Jones:** When it comes to preparing accounts, you have to follow certain professional rules. The essential criterion is that, in our estimation, there is a more than a 50% chance that that liability will fall due. Therefore, in terms of preparing the accounts, based on professional advice, we took the view that there was more than a 50% chance that that liability would become payable. Having said that, we, as well as Assembly officials, and our professional advisers, have been in correspondence with HM Revenue and Customs since September 2004. We are of the view that HMRC has been aware of our accounting treatment, and we have been visited by its officers. We are very strongly of the view that we have a very

strong defence against that becoming payable. However, in terms of accounting rules, we feel that we had to recognise that in this year's accounts. However, we feel that we have a strong defence against that, and, on behalf of the auditor general, we will be making those arguments with HMRC.

[20] **Aled Roberts:** Beth fydd yn **Aled Roberts:** What will happen if this digwydd os na chaiff y ddarpariaeth hon ei provision is not drawn down? galw i lawr?

[21] **Mr Jones:** We have put a £2.4 million provision in the accounts. If we eventually settle with HMRC at a lower level, or at zero level, that depreciation will be released, and that money will come back into the coffers. If, in that year, it is not needed, it will be surrendered back to the consolidated fund.

[22] **Darren Millar:** Given that you have been having these discussions for such a long time, why is it only now that you have made a provision in the accounts?

[23] **Mr H. Thomas:** Up until now we have been trying to ascertain what exactly we are subject to for VAT. If you recall, last year, I mentioned that there had been a settlement with some of the other audit offices, particularly Audit Scotland. Therefore, we hope that that would accelerate a consideration by the VAT officers dealing with us. On page 7 of my letter to you, we set out the position that HMRC has, this year, confirmed that I cannot rely on two of the sections on which we had been hoping to rely in terms of the regime that we have been operating. That means that we have now passed that threshold that Terry talked about. We now have a certainty that we have to pay VAT. To clarify our position, the issue that still has to be sorted out with it is the extent of such liabilities. So, that is the change. Whereas previously there was uncertainty about both status and liabilities, we are now into an uncertainty about liabilities.

[24] **Mohammad Asghar:** Huw, could you explain to the committee what has happened during the year to turn this former contingent liability into a provision? Do you expect the issue to be resolved?

[25] **Mr Jones:** Picking up on the points that the auditor general has just made, there have been two changes in the past few months. One is a ruling by HMRC regarding the status of the auditor general. The second, as I referred to previously, is that we have been in correspondence with HMRC since September 2004, and this has bounced between different sections within HMRC and the Treasury. In recent months, we have established a contact with a single, dedicated office, which is now resolved in moving this forward with us. So, whereas previously, in the past seven years or so, there has been no single point of contact with which to have a dialogue within HMRC, we now have that dialogue and I think that it is helping us to sort things out and move forward.

[26] **Mohammad Asghar:** Is this contingent liability accumulated or is it just a one-off for one year? How long have you been negotiating with HMRC? Has it been going on for the last eight years? I think that that is unacceptable.

[27] **Mr Jones:** On the liability in the accounts—the provision—HMRC can go back four years. That is what the liability in the accounts represents. As I said before, I think that one of our defences is the fact that we have struggled to get a response from HMRC for a number of years and that no single point of contact within HMRC has accepted responsibility for this. It has been extremely frustrating for us, but I think that we are getting to a point, now, at which we have contacts in HMRC who are ready to work with us to move this forward.

[28] **Mr H. Thomas:** We may be at the end of the chain in terms of the audit offices that

HMRC has been dealing with on this issue, but we have not been alone in trying to ascertain the exact position. As Terry said, it predates the whole establishment of the Wales Audit Office. It affected Audit Scotland and the Audit Commission, and it seems incredible that VAT officers have taken so long to reach a position.

[29] **Mohammad Asghar:** I think that you are being very kind to them.

[30] **Julie Morgan:** It seems extraordinary that HMRC is so unresponsive. Would you say that it was unresponsive to the dialogue?

[31] **Mr H. Thomas:** Obviously, I came late to this discussion, but I find it odd that HMRC has been responsible for VAT and has not had a dedicated office, because it would be the same issue that would have applied for Audit Scotland, the Audit Commission and ourselves. Instead, we have all been dealing with different parts. It almost seems like it has been happy to pass the ball to another part of the organisation. Ultimately, the difficulty was that, unless we could ascertain our position, I would be coming to you every year and saying, 'These are the accounts, but I might be back'. However, now we know that this is the worst that we are going to face. We are into the arguments with HMRC and therefore we are saying, 'We should not pay this, because it is your error that has led us to having to wait so long'.

[32] **Julie Morgan:** What if you had to pay it?

[33] **Mr H. Thomas:** We will have to pay, eventually.

[34] **Julie Morgan:** How will you pay it?

9.45 a.m.

[35] **Mr H. Thomas:** We have now had a provision set aside. We will obviously bargain it down. This is the worst position that we have been in, to the extent that our bargaining down exceeds the financial position that we have. We might need to come back and seek a supplementary estimate. The real plus would be that we would only have to pay from the point of determination onwards. In which case, much less of a provision needs to be made. However, as Terry and Ann-Marie have said, under the accounting rules, we have to show that there is more than a 50% chance, therefore, we are showing the full provision.

[36] **Julie Morgan:** Would it be likely to be much less than the £2.4 million, even if there is a provision that has to be paid?

[37] **Mr H. Thomas:** Well, I look to the team to my right to achieve that.

[38] **Mr Jones:** We cannot say at this point in time whether it would be much less or not. We think that we have strong defences and arguments to make, but we are still in the process of making those arguments and awaiting response to those arguments. As the auditor general says, £2.4 million is the maximum. We would hope that HMRC would recognise our arguments, but we are in its hands, and if it does not we will have to consider with the auditor general whether it is appropriate to go down the route of a VAT tribunal and to continue to make those arguments, through a tribunal.

[39] **Julie Morgan:** So, if you end up having to finance something and you do not want to come back to the committee, how would you do it? How would you get that money?

[40] **Mr Jones:** We have made a provision within the accounts for £2.4 million, so, from an accounting point of view, there is cover for that. What we do not have full cover for is the cash, because there is a timing difference between when we have made the provision in the

accounts and when the cash may become payable. You will see in the accounts, on the back of this year's accounts, that we have returned £1.9 million of cash to the consolidated fund.

[41] Picking up on an earlier question, there is a £1.2 million deficit in our balance sheet. That represents a difference between the provision that we have put in the accounting terms and the cash that we may have to pay if that liability becomes payable. The key challenge for us is finding the cash. If that becomes payable, it is likely that we would have to return to the consolidated fund, effectively asking for some of that £1.9 million cash that we have returned this year in order to be able to pay the liability for future years.

[42] **Mr H. Thomas:** Much depends, as I said, on the point of settlement. We have put it in, and it is the worst position. My accounting requirement is to balance one year with the next and, therefore, in a sense, I do not have to hit the nail on the head every year, but I can do it over a period. So, I would hope that whatever settlement we reach would be one that would allow us to spread the payment of liabilities.

[43] **Darren Millar:** I assume that you are discussing the possibility of further draw-downs with the Minister for Finance, and the Welsh Government.

[44] **Mr H. Thomas:** I met the Minister for Finance recently and brought her up to speed with the VAT issue, among other things.

[45] **Aled Roberts:** Yn hytrach na chyllideb ychwanegol, a yw'n bosibl codi'r ffioedd neu chwilio am fwy o fesurau effeithlonrwydd yn eich swyddfa?

Aled Roberts: Rather than a supplementary budget, would it be possible to raise the fees, or to look for more efficiency measures within your office?

[46] **Mr H. Thomas:** Mae hynny'n bosibl. Rwy'n credu y gallwn edrych ar beth yw'r sefyllfa ar yr amser cyn i ni gyrraedd cytundeb am y dreth ar werth. Nid ydym yn gwybod eto a ddaw hynny eleni; gallai fod yn flwyddyn arall cyn iddynt ddod i benderfyniad, felly bydd yn rhaid i mi edrych ar y sefyllfa yn y swyddfa ar y pryd. Nid wyf eisiau dod yma a dweud oherwydd bod gennym setliad, rydym eisiau pres ychwanegol. Buaswn eisiau dod a dweud, 'Rydym wedi cyrraedd setliad. Dyma yw'r sefyllfa yn y swyddfa, ac felly dyma yw'r effaith.' Byddaf yn edrych i weld a oes mesurau effeithlonrwydd y gellid eu dilyn yn y swyddfa lle gallaf arbed pres.

Mr H. Thomas: That is possible. I think that we could look at what the situation is when we reach an agreement on the value added tax. We do not yet know whether that will come this year; it could take another year before they reach an agreement, so we will have to look at the situation within the office at that time. I do not want to come before you and say that because we have a settlement we want additional funding. I would want to come to say, 'We have reached a settlement, this is the situation within the office and, therefore that is the effect.' I will look at whether there are efficiency savings to be made within the office where I can save money.

[47] **Jenny Rathbone:** The man on the No. 58 bus will be struggling with this one. I think that the Chair should write to George Osborne, recommending that his department gets its act together because this situation is really not a good use of public money. I appreciate that the status of the auditor general is one thing, and that is complicated by the nature of your position, but I am still struggling with the VAT status of people undertaking work on your behalf. What proportion of people undertaking that work are PAYE employees and what proportion are freelance? I can see that there is occasionally a need to take on self-employed people, but surely most of your staff are PAYE employees.

[48] **Mr H. Thomas:** Yes, with regard to our tax and PAYE provision, basically, the work that I do is divided up something like this: about 25% to 27% goes out to firms and we do the

rest within the Wales Audit Office. From time to time, we need to supplement the expertise of my staff. That may be because of a peak in work. There was one occasion recently where we ended up having to find staff to do some fairly quick studies. At other times, it may be that I need a specialist in a particular field. We then engage them. This is where the difficulty arose. We have engaged people on contracts. The contracts had to be tested and, of course, if someone continues to work for a particular organisation over a period of time they cross the line where you can easily regard them as a contractor and you start to have to assume that they are part of your organisation and pay PAYE and national insurance contributions. We have discovered over the years that a few very valuable extra people were used by us with sufficient frequency in the course of a year to cross that line. Therefore, we have had to arrive at a declaration that about £165,000 is due to Her Majesty's Revenue and Customs for that and then within our organisation we have pulled back the contracts, redone them and introduced a much tighter control to avoid the sort of drift that resulted in this liability. Do you want to add to that, Ann-Marie?

[49] **Ms Harkin:** I think that you have covered it all. We are meeting HMRC on 12 October to discuss this. Subsequently, we have had a look at the figure of £165,000 and we think that, in reality, it may be slightly less than that. However, a great deal will be dependent on our discussions with HMRC on 12 October.

[50] **Jenny Rathbone:** I am still struggling to understand how you got yourselves into this position given the nature of your work, which has been ongoing for many years. It is clear that, if you ask someone to do a piece of work for a month or two months on a specific best-value study, a freelance contract may be the appropriate thing. However, surely your human resources department must be mindful of the fact that you have already employed that person. How come that was not identified? It is clear that, once you have employed someone for so many days, they have to be on the staff.

[51] **Ms Harkin:** It is not as clear-cut as just the number of days. There are a number of tests that need to be fulfilled. In any case, I do not think it is clear-cut that we have definitely not met any of the tests for a particular person or people who are self-employed. What we have is a situation where three or four of the tests, in the view of our tax advisers, do not necessarily meet the criteria for someone being self-employed. That is why I said that there is still a discussion to be had with HMRC. There is an argument in some cases that these people were justifiably self-employed and that we were treating them correctly. As the auditor general has explained, this has happened over a period of time. We have identified this problem and we have now put it right. It is unfortunate that it happened. I think that the actual payment will be less in the event. We have put the situation right and we identified it, but it is not ideal.

[52] **Jenny Rathbone:** So, do your contracts of engagement specify that, for the time being, someone will be on a self-employed contract but that that might change if the VAT—

[53] **Ms Harkin:** At the moment, we are not issuing any self-employed contracts. We are taking a completely no-risk approach to this, given the circumstances. All of the contracts that we are issuing at the moment are for staff on payroll, and that is where we will be until such time as we have had discussions with HMRC. We have totally reviewed our contract in discussion with our lawyers, and we now have a contract that is watertight.

[54] **Darren Millar:** Aled, did you want to come in?

[55] **Aled Roberts:** Is it the case that, historically, those tests were not applied, or were the tests applied and the wrong call made?

[56] **Mr Jones:** To be honest, I think that it is quite complicated. We have taken on a

small number of contractors. They have been taken on for a piece of work that has been extended. In all honesty, perhaps there has not been an overview across the organisation of exactly what these individuals have been doing at certain points in time. Probably, until we started looking at it now, we did not appreciate what the tax rules were. As Ann-Marie has explained, they are not straightforward. Even when we have sat down and looked at these individuals, we have found that it is not straightforward as to whether they should be classified as employees or self-employed. We have now created more central control, so that no-one bypasses the central consideration of these arrangements. In the past, there has not been a full appreciation of the complexity of the tax regulations, and that has been the problem, but as the auditor general and Ann-Marie have said, we have now put controls in place to make sure that that does not happen again.

[57] **Darren Millar:** Usually, the risk associated with any tax liability would fall upon the self-employed person, would it not, rather than the organisation engaging in contractual services with them? Why are you making this provision in your accounts?

[58] **Mr Jones:** The failure, if there is a failure, on our behalf would be a failure to operate pay-as-you-earn. We have a legal obligation to operate pay-as-you-earn for people that HMRC would regard as employees. Ann-Marie mentioned that we would hope that the liability would be less than £165,000. One of the main reasons for that is that, although it is not obliged to do so, HMRC will normally offset tax that self-employed people have paid through the self-assessment system. Therefore, we are hopeful—assuming that these individuals have paid the tax—that our liability, to the extent that we have a liability, will only be the employer’s national insurance element. So, we would hope that it would be a quarter or a third of what is in those accounts. Essentially, if there is a failure, it is a failure to operate pay-as-you-earn and the employer’s national insurance.

[59] **Darren Millar:** Did you wish to come in, Oscar?

[60] **Mohammad Asghar:** I just wish to have some clarification. I understand VAT, which you receive. You are a service organisation, not a manufacturing company or anything like that, so whatever you receive, you pay back to VAT, deducting your own expenditure claim with VAT on it. How had this accumulated? Where was your money actually stuck, and where have you not paid? This is my concern. I am referring to VAT. Where was the VAT not received by you? Are you paying HMRC?

[61] **Mr Jones:** In terms of how VAT operates for us, and in terms of liability, which has gone into the accounts, one of the issues that we are considering with HMRC is on how much of the work of the auditor general should VAT be charged. We have inherited historical practices from the predecessor organisations and we are currently charging VAT on around two-thirds of our work. The worst-case scenario, which is what the provision is based upon, is that HMRC may contend that we can only charge VAT on 5% of our work. In terms of VAT liabilities, that means that, rather than being able to recover two thirds of the VAT that is charged to us, we will only be able to recover 5% of the VAT charged to us. , If HMRC goes down that line, that effectively means a 60% difference each year between the VAT that we have recovered and what was recoverable. I know that it is quite complicated, but there is a direct link between the VAT that we can recover and the VAT that we are supposed to charge on the work that we do. That is the technical debate that we are having with HMRC at the moment: what work should VAT be charged upon, and what work should VAT not be charged upon?

[62] **Mohammad Asghar:** Is it a matter of incompetence or ill-informed judgment somewhere along the line? It should be straightforward, with HMRC very regularly sending all the informative material, and keeping things pretty up front, rather than coming after you so many years later, and you getting this big liability on your shoulder.

10.00 a.m.

[63] **Mr Jones:** There has been regular dialogue.

[64] **Darren Millar:** Of course, I assume that this liability or provision is growing all the time while it remains unsettled.

[65] **Mr Jones:** The maximum that HMRC can do is to go back four years, so that starting point shifts as it delays its deliberations.

[66] **Ms Harkin:** Of course, you are right; we continue to be in this situation, and even for the current financial year, we do not really know where we stand, so this needs to be resolved quickly.

[67] **Mike Hedges:** Can you explain why you have decided that the Wales Audit Office should meet the potential taxation charges for two of your senior managers, rather than it falling on them?

[68] **Mr H. Thomas:** Yes, I am happy to. We start with quite a bizarre arrangement, namely that HMRC defines your place of work as where you spend 40% of your time. That might be, in itself, okay, but, in reality, you can get two periods of 40% out of 100%, and we have two groups that are affected by the liabilities under this: one is the people who are below the line and, therefore, easily defensible, and the other is a bit more difficult in terms of defence. My staff are required to audit bodies and—particularly the financial auditors—they develop over a period quite a strong pattern of attendance at that base; they also have a base at our office, where they are probably going to be for 40% of the time, but they are actually accumulating two periods of 40%. For example, it might be in Cardiff and Llandrindod Wells—wherever the base of the audit is. If that HMRC rule is to be sustained, what happens is that every time they travel to their place of work at the office, it is—fair enough—a home-to-work journey for which there is no reimbursement. However, if they travel from their home to Llandrindod Wells, that also, according to HMRC, should be at their expense. So, we are requiring staff to work at their own expense. I think that that is wrong. We know that other audit offices have had this experience with HMRC and have reached some kind of settlement with it; we hope to achieve the same ourselves, not least because we rotate staff. They can only be with an audited body for a certain length of time, then we must move them on, in order to ensure their objectivity and so on.

[69] That is one group of staff, but the same 40% rule has caught two of my staff whose homes are in north Wales and who are doing an all-Wales job, but are based in north Wales. They also have to be in Cardiff. They do not have constituency exemption, which some of you around the table have. It means that if they are there working in north Wales on Monday and Friday, they have established that 40%, but if they are in Cardiff for part of the rest of the week, that too is 40%. Essentially, that means, according to HMRC rules, it seems to me, that if anyone has to do an all-Wales job, they have to move to Cardiff in order to avoid getting into that trap where any travel is at their own expense. I think that that is wrong. In fact, I distinctly remember our first First Minister making a pledge that devolution to Wales would not mean devolution to Cardiff and that it would benefit the whole of Wales. As I have referred to in my letter, we are not the only all-Wales organisation that is having this discussion with HMRC. It affects a large number of other Welsh public bodies, including the Welsh Government.

[70] So, going back to why we include staff within provisions, on this one, in relation to two staff members, the pattern is so well defined, and there is no rotation, that I think that we are probably due for liability. On the others, where there is a rotation, the judgment as to

whether we are liable or not is sufficiently challengeable for there to be no need for a provision in that regard. It is the same argument; it is just that, on two of them, I consider them to have crossed the line, and that is in the light of discussions that I know HMRC has had with Welsh Government.

[71] **Mike Hedges:** This is a management question for you, really. Why can you not ensure that the people need to be in Cardiff for only one and a half days a week, which would make up only 30% of their time and, consequently, fall under the 40% rule?

[72] **Mr H. Thomas:** That is why, when you see the estimates that you will eventually get from me, you will see that I am proposing a significant investment in, among other things, video-conferencing.

[73] **Ms Harkin:** I would just add that it is not as clear-cut as the 40%. If I were to establish a regular work pattern of going somewhere every Monday, for example, HMRC might be able to contend on that basis—and I stress the ‘might’—that that is a regular and permanent place of work for me. So, it is not as clear-cut as just 40%. The 40% automatically triggers it, but just establishing a regular pattern of attendance somewhere can also trigger it.

[74] **Mike Hedges:** To come back to managing the issue, if someone comes down on Monday one week and on Wednesday another week, two days the following week and nothing the week after, that would make the pattern an irregular one, so it would, consequently, not become a regular pattern, would it?

[75] **Ms Harkin:** I think that it would, but I also think that we would have to be careful that we were not then accused of tax avoidance. That would be something that we would have to be quite careful of.

[76] **Darren Millar:** I think that you should stick Mike in there as your defence. *[Laughter.]*

[77] **Mike Hedges:** I can understand where HMRC is coming from, and I can understand the position that people work in either one place or another. If the two places are on separate sides of Wales, then I think it comes down to managing the issue.

[78] **Darren Millar:** This 40% threshold is a very interesting one because, as you say, you can establish two main bases of work and not be able to claim expenses between them. It seems absolutely remarkable.

[79] **Mr H. Thomas:** That means anywhere in between as well.

[80] **Darren Millar:** It is astonishing.

[81] **Lindsay Whittle:** I would like to ask questions on two issues. The first is on the Welsh consolidated fund. You are allowed to draw down £5.3 million. Why did you draw down the full authorised amount for 2011-12, when it was clear from the accounts that not all of it was needed? You are going to have to repay close on £2 million, but of course, that £2 million was sitting in your account. I know that interest is not very high at the moment, but it might be a bit high on £2 million, I would suggest.

[82] **Mr Jones:** We have to look at our accounts and understand that we get income and cash from different sources. We get income and cash from audit fees, and we get income and cash from the consolidated fund, and we use them for different purposes. The funding that we receive from the consolidated fund is for staff salaries, for VFM studies and other work that underpins that, and that happens every month. We have drawn down the cash from the

consolidated fund for that expenditure, and we have to be very clear about keeping the cash that we receive from audit fees separate. I think that our audited bodies would be quite unimpressed if they thought that we were taking their cash and using it for activities that the consolidated fund should be funding. It is a question of ring fencing, in that different activities are funded from different sources. So, the consolidated fund cash has been used for particular sources, and the £1.9 million that has been returned to the consolidated fund arises from some of the additional work that we have done during the year, because of the way that the consolidated fund rules operate. So, the fact that they are different sources of income and cash is the key point.

[83] **Mr H. Thomas:** This is an area where, once we are through the legislation, those parts contained in the provision that I referred to earlier will be easier in future years. At present, we have to ring-fence, under our operating requirements.

[84] **Darren Millar:** But you do not have to draw down unless you need it, do you?

[85] **Mr H. Thomas:** It is using funds that have come particularly from local authorities for those purposes that are the consolidated fund's requirement at present, where we charge the consolidated fund as opposed to local authorities. We cannot cross; we have to keep the funds and the way in which they operate separate. Under the new legislation, that will go, and we will have one pool of money. That means that we can operate more easily in terms of consolidated funds.

[86] **Darren Millar:** However, you are able to forecast the cash requirement for your consolidated fund work, and yet it was massively out this year, was it not? So, there would be no need for you to draw down those funds from the consolidated fund. Presumably, you have a handle on your cash requirement.

[87] **Mr H. Thomas:** When it became clearer towards the end of the year that significant funds were coming in from other sources—the extra work that we had done and the extra grant work that had to be done—the automatic drawdown should have been looked at in the last quarter.

[88] **Darren Millar:** What will you do in the future to make sure that we do not get into a situation where such an enormous amount is drawn down when it is unnecessary to do so?

[89] **Ms Harkin:** That is something that we are looking at currently. It is something that we have looked at. It involves our cash management, and we have to get on top of that.

[90] **Lindsay Whittle:** The people that you employ are your biggest asset, of course. You employ 254 members of staff, I think. I notice that there is a very small number under the age of 25, which is rather sad; it is less than 2%, which is way below the national average. I notice that you lost seven members of staff last year, six of whom left with a package worth between £100,000 and £150,000, and one with a package worth between £300,000 and £350,000. So, seven people left your organisation with close to £1 million. That is a bit of a lottery win. Is there any explanation for that?

[91] **Mr H. Thomas:** Regarding the ones who left during the course of the year, basically, we have been trying to re-skill. When I appeared previously—I think that it was on the estimates—I was saying that we were looking to have a severance package because we wanted to lose people, but actually the reason we wanted to lose them was because I was restructuring to get in a particular set of skills. So, it is not a lottery win. All applications for voluntary severance were looked at. They could only be approved where we saw a return, and where that skill-set rule applied. We had less of an uptake than I had hoped to have. If you remember, we came before the committee and said that we thought that around £750,000

would be needed in the course of the year in terms of the severance packages. In fact, we only used £350,000 of that. This year, about £250,000 of our own and £100,000 of the supplementary estimate have been used, so the balance was returned.

[92] In terms of skills, we are now engaging in recruitment, particularly in the area of performance, and getting more trainee posts into the financial audit side. So, we are trying to redress. However, given that the need is for financial audit in particular or others with particular experience, we will always be an organisation that does not have a 100% match with the standard in terms of the employment of people at very young ages in the working population.

[93] **Lindsay Whittle:** Should I be reassured that there is some reorganisation and definitely long-term savings?

[94] **Mr H. Thomas:** Yes, there are. I am not seeking a new voluntary severance package. As far as I am concerned, that has finished. However, we are looking to recruit extra people with particular skills in performance and to keep renewing the base of our trainee auditors. I should say that we recruit more trainee auditors than we need. Those whom we recruit who are unsuccessful in gaining permanent positions with us will, I hope—and, indeed, it is the case—go on to make their careers in the profession, and many of them in the public sector in Wales.

10.15 a.m.

[95] **Darren Millar:** Aled, you wanted to come in on this point.

[96] **Aled Roberts:** Gan ein bod yn sôn am daliadau, ar dudalen 57, rydych yn sôn am ‘fuddiannau mewn da’, gan gynnwys ceir ar brydles a materion felly. Yn y sector cyhoeddus, ac awdurdodau lleol yn arbennig, mae newid wedi bod o ran darparu ceir i staff. A ydych yn adolygu rhai o’r costau hyn yn eich adran chi?

Aled Roberts: As we are discussing payments, on page 57, you talk about ‘benefits in kind’, including leased cars, and so on. In the public sector, and local authorities specifically, there has been a change with regard to the provision of cars to staff. Are you reviewing some of these costs within your department?

[97] **Mr H. Thomas:** Ydym. Bu inni gytuno’r system sydd gennym ar hyn o bryd gyda’r undebau rhyw flwyddyn yn ôl. Mae’n lleihau’r costau i ni o ddarparu ceir. Mae’n rhaid inni gael rhyw fath o ddarpariaeth er mwyn sicrhau y gall staff deithio o gwmpas Cymru i wneud eu gwaith. Fodd bynnag, rydym yn parhau i adolygu hyn. Roeddwn o dan yr argraff bod y pwyllgor yn bwriadu comisiynu ein harchwilwyr allanol i wneud astudiaeth i sicrhau eich bod yn hapus gyda’r hyn rydym yn ei wneud.

Mr H. Thomas: Yes, we are. We agreed the system that we currently have in place with the unions around a year ago. It reduces our costs in relation to providing cars. We have to have some kind of provision in order to ensure that staff can travel around Wales to do their work. However, we are continuing to review this. I was under the impression that the committee intended to commission our external auditors to undertake a study to ensure that you are content with what we are doing.

[98] **Julie Morgan:** With regard to the governance issues, could you elaborate on the nature of the apparent weaknesses in financial management that were highlighted in the governance statement and which are now being addressed?

[99] **Ms Harkin:** Do you mean those beyond the issues that we included in the—

[100] **Julie Morgan:** Obviously, you have discussed some of those issues today, so, yes,

beyond those issues.

[101] **Ms Harkin:** They are pretty much summed up in those four bullet points, really. We need to improve our financial management and management accounting. We have made significant improvements, but we are continuing to look at that as an area of improvement. As we said in our letter to you dated 26 September, we have created an additional temporary post specifically for this purpose in the finance department. The aim is to ensure greater consistency and a more joined-up approach across the organisation. So, we are doing a lot of work to improve our financial management information. That is a huge area of work for us at the moment.

[102] Terry has touched on the employment tax regulations, and we are happy to provide more information on that if you need it.

[103] On policies and procedures, we have done a lot of work in this area. Issues were raised regarding the need to improve our guidance, our policies, and general guidance on procurement, and hospitality expenditure—the sorts of things that you would normally have and which would need to be updated regularly. We have accepted that we need to look at those again. I have recently finished writing, with colleagues, a financial management handbook, which goes into a lot of detail. It runs to about 50 or 60 pages and contains a lot of proper guidance. We will be rolling out training to all our budget holders and budget heads on the back of that. Training will also be given to staff within the organisation who manage projects, so that they get a greater understanding of the fact that they should be booking their time to do the jobs promptly and accurately, so that we can recognise income in our accounts and in our financial management information. So, a huge amount of work is going on in this area at the moment to address the points that have been raised in the annual governance statement.

[104] **Darren Millar:** One area that we have not really touched upon is the fact that your fee income was much higher this year than you had anticipated, and you have managed to squeeze some efficiencies in terms of your costs. They would be very welcome if you were a commercial enterprise and were seeking to make a profit, but, of course, you are not there to make a profit, you are there to provide a service at cost to local authorities, health boards, and so on, in terms of their work. Does this mean that you are charging too much to those public bodies? Will you reduce your fees this year in order to compensate?

[105] **Mr H. Thomas:** The estimates will show a reduction in fees, but what has been quite interesting is the impact of our reports on grant management. They led to a number of local authorities submitting additional work and clearances of grants that had been stockpiled. So, we got an unexpected windfall from that—not only us, but the firms who do work for me with some bodies. In fact, one local authority seemed to have been sitting on a huge backlog of grant claims, which we cleared for it. There is also the fact that we have done a number of specialised extra studies this year, some of which you will all be seeing shortly. However, we have also had an increase in public interest reports, for which we charge, and in special inspections, for which we charge extra. So, an extra amount has been coming in, which we had not anticipated, and that is not far off around £0.9 million in terms of that extra work. However, in answer to your basic question, yes, next year, I propose a reduction in fee levels.

[106] **Darren Millar:** That is welcome news. Conveniently, the additional income and reduction in expenditure enabled you to offset the HMRC liability, which is handy in the current financial year.

[107] That brings us to the end of our questions on the accounts. It just falls to me to ask Members if they are prepared to note the accounts with the explanations provided by the auditor general and his team and also to ask you, auditor general, to provide us, if you would,

this side of Christmas, with an update on the financial management improvements, as well as an update on your procurement improvements, given the reference in the report, and an update on the negotiations with HMRC on VAT and other tax liabilities.

[108] **Mr H. Thomas:** Certainly.

[109] **Darren Millar:** Thank you very much indeed. I also suggest to Members that we ask the auditors, RSM Tenon, to undertake a value-for-money study into travel and subsistence at the Wales Audit Office. Are Members content with that?

[110] **Mr H. Thomas:** May I clarify that? This is a different one to the earlier suggestion of the car scheme.

[111] **Darren Millar:** Yes.

[112] **Mr H. Thomas:** Right; okay.

[113] **Darren Millar:** Are Members happy with that? I see that you are.

10.21 a.m.

**Cynnig o dan Reol Sefydlog Rhif 17.42 i Benderfynu Gwahardd y Cyhoedd
o'r Cyfarfod
Motion under Standing Order No. 17.42 to Resolve to Exclude the Public
from the Meeting**

[114] **Darren Millar:** I move that

the committee resolves to exclude the public from the meeting for the rest of our agenda in accordance with Standing Order No. 17.42.

[115] I see that there are no objections. Thank you.

*Derbyniwyd y cynnig.
Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 10.22 a.m.
The public part of the meeting ended at 10.22 a.m.*