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Dear Llyr

Reference: AC087/MP/SD

Date: 22 February 2019

Directly funded bodies' annual budget proposals

Thank you for your letter of 14 January 2019 seeking views on guidance to directly funded bodies for formulating their annual estimates.

As you indicate in your letter, linking the budgets of directly funded bodies to change in the Welsh block is difficult for various reasons. Apart from differences of interpretation and timing problems arising from UK Government funding decisions, the development of Welsh taxes detracts somewhat from the usefulness of changes in the block as a measure of affordability. More fundamentally, however, I do not think that such a reference figure approach is conceptually the best way to ensure expenditure approval is appropriate, as it means that there is insufficient consideration of the merits of spending proposals.

I think it would be better if the primary focus in considering estimates was in terms of proposed activities and the estimated costs of those proposed activities. The estimate should be examined so as to see whether there is credible explanation of the estimated cost of the planned activities for the year and their intended benefits, along with how the organisation is ensuring savings and efficiencies in how it works. This should include proposed changes in activity to meet changes in demand. A focus on the estimate along those lines should help ensure that only worthwhile and necessary expenditure is approved.

I recognise, however, that it is desirable to some extent for the Committee to have a reference point, such as a relevant inflation measure, so as to have an initial indicator of cost control. But I would emphasise that I do not think that a focus on such a reference point would lead to real rigour in assessing expenditure proposals.

Most directly-funded bodies' expenditure is on staffing – so pay and pensions pressures will be significant drivers – but also necessarily includes substantial amounts on other items, such as accommodation and IT. A broad measure of inflation, but one which includes government services, would therefore seem appropriate. A prudent measure may therefore be the GDP deflator forecast (see <https://www.gov.uk/government/collections/gdp-deflators-at-market-prices-and-money-gdp>).

The OBR figures are UK figures, and they do not relate specifically to the amount of funding available in Wales. It could be argued that Welsh Government spending plans, as set out in the final budget in December each year, and particularly the change in Revenue and Capital Departmental Expenditure Limits (RDEL and CDEL), are more relevant for gauging the affordability of proposals in Wales. The increase in RDEL and CDEL set out in the 2019-20 budget is in aggregate 4.8% (4.5% and 6.9% respectively). However, in my view, the timing of the availability of confirmed figures may make that measure somewhat impractical, and it is also too narrow, in that directly-funded bodies' activities are not in lockstep with Welsh Government activities. The audit activity of the WAO, for example, is unlikely to be required to vary in direct proportion with Welsh Government total expenditure. This applies both during periods of increasing Welsh Government expenditure and in periods of austerity.

I should also emphasise that there is a danger of pursuing spurious accuracy in relation to reference figures. As set out above, I think that it is more important to ensure that proposed expenditure is on activities that have real merit, rather than to establish that it conforms to a wider pattern.

For context, it may be helpful if I describe the approach to producing the estimate that I prepare and submit jointly with the Board of the WAO. This is essentially a matter of “building from the bottom up”, i.e. starting with the resources needed to undertake the Auditor General's work programmes for the year, coupled with the costs of running the Wales Audit Office, plus funding any innovations, modified by estimated cost pressures and potential for efficiencies and savings. Of course, we approach our annual Estimate in the context of our Medium-Term Financial Plan and the wider funding pressures facing public services. The Board challenges management to justify any proposed increases in the draft estimate on a case by case basis, and of course also has regard to the reputational risks associated with our funding and fee levels. We also see our annual consultation on fee rates as an essential component in providing both external challenge and assurance that the WAO itself is operating in a cost-effective manner. I think the merits of this approach can be seen from the fact that since 2013-14, the WAO has reduced its own operating expenditure by 14% in real terms.

Overall, my view is that it would be best if the focus of consideration was on the justification of the items of expenditure proposed—the value for money they present. I think it would be appropriate for this to be informed, but not bound by,

subsidiary consideration of inflationary pressures and the context of the trend in the Welsh Government budget.

I hope the above comments are helpful. I should be happy to elaborate if the Committee wishes.

A handwritten signature in black ink, appearing to read 'Adrian Crompton', with a long horizontal stroke extending to the right.

Adrian Crompton
Auditor General for Wales