

Driving Improvements at Local Government External Auditing: A Lesson for Malaysia

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Introduction

External auditing has had a long history of assuring stewardship and accountability between principal and agent, mainly in the private sector but also encompassing and benefiting the public sector. As it works more consulting-like for the public sector or non-profit organization, it has been used widely as one of many inspection activities performed on local authorities especially in the developed countries. In the local government, audit started as tools to provide assurance concerning the reliability of the accounts of an authority and on the legality of the underlying transactions. However, since the 1980s, external auditing has been applied in a variety of contexts referring to new and (or) more intense account-giving and verification requirements (Courville et al, 2003), which is argued by Power (1997) as the 'audit explosion'. This article intends to introduce the success of external auditing in driving improvement at local government in England so their experience could be shared among managers of Malaysian local government and public sector at large.

Utilising External Audit for the Public Sector

An effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their government accountable (The IIA, 2006). Auditors perform an especially important functions in those aspects of governance that are crucial in the public sector to promote credibility, equity, and appropriate behaviour of government officials, while reducing the risk of public corruption. Therefore it is crucial that government audit activities are configured appropriately and have a broad mandate to achieve these objectives. The audit activity must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary.

Government auditing supports the governance roles of oversight, insight and foresight (The IIA, 2006). Because government's success is measured mainly by its ability to deliver services successfully and carry out programs in an equitable and appropriate manner, government audit activities should have the authority and competency to evaluate financial and program integrity, effectiveness, and efficiency. Auditors also have to protect the core values of the government as it serves all citizens.

The public sector represents a principal-agent relationship (The IIA, 2006). The officials, acting as the agent, must periodically account to the principal for their use and stewardship of resources and the extent to which the public's objectives have been accomplished. The inherent risks in the principal-agent relationship may be reduced by an effective accountability mechanism. Thus, governments place greater value on public audit to secure local authorities' accountability (Laughlin, 1996). There has been much evidence of increasing inspection activities since 1980s which is described as audit (Kelly, 2003; Hood et al, 1998). The principal relies upon the auditor to provide an independent, objective evaluation of the accuracy of the agent's accounting and to report on whether the agent uses the resources in accordance with the principal's wishes. This is also reflected in Power's (1997) argument that there had been an explosion in audit, in which auditors' work extends to cover assessment of services. The author also argues that there are more people watching and less people doing; increase in the policing of policing where an auditor inspects the control systems of local government. The money spent for these policing of policing activities is also increasing (Hood et. al., 1999).

Accountability is said to be improved by transparency, when an agent is required to provide more information, that would make them more accountable and more likely to work for common good (Prat, 2006, Heald, 2006b). However, there is not more transparency in practice for several reasons such as that 'strong entrenched interests' prevent transparency, full disclosure may not be an optimal policy, the direct cost of information disclosure and difficulty in communicating the information (Prat, 2006, p. 94-96). Introducing or increasing transparency would be beneficial only if it is seen to make a difference (Heald, 2006a). Furthermore, the ability to objectively measure efficiency, effectiveness and economy has always been argued by many researchers to be problematic because of its complexity for auditors and as a concept in practice (Lapsley and Pong, 2000).

English Local Governments' Experience

In the context of local authorities in England, the establishment of the Audit Commission (AC) was clearly an important landmark. Although inspection is not new for English local authorities, its intensity has been increasing since the 1980s, because of government concern that local authorities and councillors were losing accountability, effectiveness, even legitimacy (Kelly, 2003). Governments have had recourse to placing greater value on external auditing to secure local authority accountability to their various stakeholders (Laughlin, 1996). External auditors' work for local authorities in England covers the Use of Resources (UoR) assessment which is one component of the Comprehensive Performance Assessment (CPA) regime. Figure 1 below shows the framework of comprehensive assessment performed at English local government.

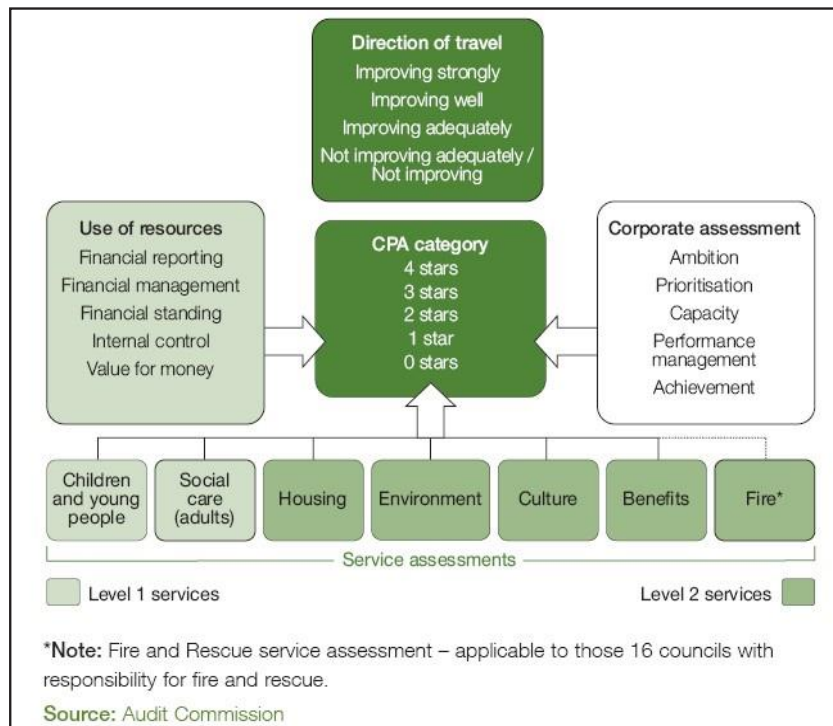


Figure 1: Single Tier and County Councils CPA –the harder test Framework for 2006-2008 (Source: Audit Commission, 2006b)

UoR assessment which also covers aspects of certification audit besides assessment of local government performance is part of the bigger assessment framework called CPA. UoR assessment is divided into five themes of financial reporting, financial management, financial standing, internal control and value for money. All these themes have specific criteria and evidence for evaluation. Local governments are invited to provide inputs prior to setting the indicators and criteria for evaluation through consultation processes. The AC communicates and disseminated the indicators, criteria and evidence for these assessments to all local government at the beginning of the year of audit so to provide clear picture of what local government should ensure are in place when auditors visit and evaluate their activities and documentation.

These inspection activities have been called 'auditing' and performed by auditors, even though the coverage of inspection goes beyond traditional definitions of auditing. HM Treasury (in Byatt and Lyons, 2001) believes that external review provides a potentially valuable incentive for improving performance as well as providing independent assurance on standards. Although the 'Modernising Government' agenda demands that inspection activities be combined with performance management to achieve the goal of continuous improvement (Cabinet Office, 1999, p. 40), coordination and sharing of learning between

inspectorates was weak (Byatt and Lyons, 2001). Thus the AC has been proposed to take the lead role of coordinating inspection in 2001 to achieve the aspiration of 'Modernising Government' agenda.

The road travelled by AC and English local government was not easy and short. Establishment of the AC was done during an earlier period of controversy about the performance, roles, size, and funding of local government and the wider public service (McSweeney, 1988). It was part of the Conservative Government's agenda to improve local authorities, introducing 'market' systems where local authorities had to function more like business organizations. The emphasis on service standards has subsequently been maintained by the Labour Government after 1997; their pledge to improve public services during general election campaign in 1997 was a major element contributing to their electoral success (Boyne, 1998). The AC, carrying the mandate from central government to regulate local authorities since 1980 has introduced a number of inspection activities using various indicators, which have been changed from one year to another.

The AC's first set of statutory performance indicators (PI) in English and Welsh local government was introduced and applied from assessment year of 1993/94 until later in the assessment year 2001/02, when Best Value Performance Indicators (BVPI) were introduced to replace the PI. To coordinate the performance of local authorities assessed by various inspectorates, the AC introduced CPA in 2002. CPA is an extension to the auditor's work of certifying the financial statements to include certifying services provided by the local authorities. Under the CPA regime, external auditors perform their duties of inspection to gather data and evidence on almost all aspects of local authority activities from financial matters to services provided to the public. The CPA exercise is done on an annual basis and covers all local authorities in England. The AC's appointed auditors write a report on each local authority's performance and later the individual local authority performance is combined to form a report on the performance of the country as a whole. Local authorities are also ranked according to their performance ranging on a five star scale from 0 stars to 4 stars. Reports are published on the AC website. The CPA has come to its 8th year of assessing local authorities in 2009 and has gone through various changes since it was first introduced. The CPA will be replaced by Comprehensive Area Assessment in 2010.

The Evidence

Supporting arguments on the ability of comprehensive assessment in promoting improvement is an analysis of English local governments' improvement. Auditors' evaluation of local government concluded in scores of 1 to 5 have been obtained and tabulated. Mean scores were calculated and compared for all local authorities in England as well as combined local authorities in each region. This was done for UoR overall and its themes scores from 2002 to 2006. English local authorities are divided into two main categories – the single tier and county councils (STCC) and the district councils (DC). As STCC and DC represents different sizes and activities, their separation is deemed necessary to prove that the assessment regime could enhance performance regardless of local authorities' sizes.

Table 1: Overall UoR Mean Score for England 2002-2006*

Mean Score for England	2002	2003	2004	2005	2006
Single Tier and County councils	3.00	3.49	3.67	2.57	2.86
District councils				2.32	2.57
All councils	3.00	3.49	3.67	2.41	2.68

*Data presented throughout this article are from Abu Hasan, H. (2009) The Impact of External Audit and Use of Resources Assessment on Local Authorities: A Study of Yorkshire and The Humber Region of England, PhD Thesis, University of Sheffield, UK

Table 1 shows the overall UoR mean scores from 2002 to 2006 calculated for England. As the DC only have scores from 2005, the mean score for 2002 to 2004 for England is the same mean score for all STCC. The mean score for whole England shows an increased from 3.00 in 2002 to 3.67 in 2004. A break in improvement pattern exhibited from 2005 is due to the changes made on the assessment regime where *'the harder test'* was introduced. The mean score was restarted at 2.41 in 2005, and shows an increased to 2.68 in 2006. The mean score for STCC throughout England experienced similar steady increases from 2002 to 2004; a drop in the mean score in 2005 and an increase from 2005 to 2006. The mean score for the DC is lower than the STCC in both 2005 and 2006. Table below will compare results of 2005 and 2006 only, to highlight the shared improvement patterns among all English local authorities. 2005 and 2006 were chosen as both utilises the same assessment regime, CPA –*the harder test*.

Table 2: Single tier and county councils – mean scores for overall UoR based on governmental region

Mean Score for Overall UoR	2005	2006
England- 150 councils	2.57	2.86
Yorkshire and The Humber- 15 councils	2.67	2.73
West Midlands- 13 councils	2.85	3.15
South West- 16 councils	2.38	2.69
South East- 19 councils	2.53	2.89
North West- 22 councils	2.55	2.86
North East- 12 councils	2.58	3.17
London- 33 councils	2.73	3.00
East of England- 10 councils	2.20	2.50
East Midlands- 9 councils	2.56	2.67

Table 2 shows the UoR mean scores for single tier and county councils for the whole of England and also the mean scores when these local authorities are divided into their respective government regions. There are nine government regions altogether, where each government region comprises of several single tier and county councils, the numbers of councils in each region are shown in the table. From the information presented, all government regions exhibit improvement from 2005 to 2006. Variation between the regions scoring the lowest mean to the regions with the highest mean was 0.65 in 2005 and 0.5 in 2006.

Table 3: District councils – mean scores for overall UoR based on governmental region

Mean Score for Overall UoR	2005	2006
England- 238 councils	2.32	2.57
Yorkshire and The Humber- 7 councils	2.14	2.71
West Midlands- 24 councils	2.21	2.50
South West- 35 councils	2.09	2.40
South East- 55 councils	2.56	2.76
North West- 24 councils	2.46	2.46
North East- 13 councils	2.15	2.77
East of England- 44 councils	2.27	2.45
East Midlands- 36 councils	2.28	2.58

Table 3 shows the mean scores calculated for all the district councils in England and also the mean scores when these district councils are divided into their respective government regions. Although there are nine government regions altogether in England, only eight regions have district councils. Governmental region of London comprises only of the single tier and county councils. The numbers of district councils in each of the region are also reported in the table. Mean scores for the district councils are lower compared to the mean scores for single tier and county councils except for the scores of the district councils in South East and East of England regions. The variation in mean score between the regions from lowest to the highest is small, 0.47 in 2005 and 0.37 in 2006 with the South West region being the poorest performing in both years. The range of mean scores between regions narrows from 2005 to 2006 for both the single tier and county councils and the district councils.

Table 4: All councils – mean scores for overall UoR based on governmental regions

Mean Score for Overall UoR	2005	2006
England- 388 councils	2.41	2.68
Yorkshire and The Humber- 22 councils	2.50	2.73
West Midlands- 37 councils	2.43	2.73

South West- 51 councils	2.18	2.49
South East- 74 councils	2.55	2.80
North West- 46 councils	2.50	2.65
North East- 25 councils	2.36	2.96
London- 33 councils	2.73	3.00
East of England- 54 councils	2.26	2.46
East Midlands- 45 councils	2.33	2.60

Table 4 shows mean scores calculated for the whole of England and its nine regions combining both the STCC and the DC. The best performing was London in both years (London has no district councils). The worst performing was the South West region in 2005 and East of England region in 2006. However, the range between the best and worst performing region not wide, 0.55 in 2005 and 0.54 in 2006.

What Malaysia Could Learn

The results analysed above revealed patterns of improvement in local authorities' performance. This pattern indicated that the comprehensive performance measurement coupled with clear indicators, effective audit and communication are good drivers for improvement. The assessment method also has to be regularly evaluated and upgraded to foster continuous improvement effort. Although the change in assessment regime resulted in a drop of scored performance, the scored performance seems to be higher in the following year. Clearer indicators and effective measurement by auditors also encouraged learning and motivation among the staff at local authorities. Local authorities would have clearer target with the indicators and detailed procedures and evidence that are required of them. These will attain their focus and encouraged local authorities to exhibit good achievement. However the assessment regime has to be carefully designed, consulted and communicated among all stakeholders to achieve an optimum measures so to avoid measuring the unnecessary. Therefore similar effort could be initiated at our local government. Starting from clear objective statements, detail assessment criteria can be developed, consulted and communicated to the local authorities.

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