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# Auditing the financial crisis

**Martin Sinclair – Executive Leader**

18 June 2014   Wednesday   Seminar

# The Key Elements of the crisis in the UK

- The wider economy:
  - Sudden and rapid downturn in output
  - Severe distress for businesses and consumers
  - Massive QE programme over several years
- Financial sector:
  - A series of dislocations in credit markets leading to extreme vulnerability of the banking system
  - Massive Government support
- A growing fiscal deficit:
  - Severe and chronic mismatch between Government expenditure and revenues
  - Sustained budget cutting over a period of years
- Impact on the NAO
  - Budget reductions
  - Re-evaluation of our value proposition
  - Transformation

# Support to the banks totalling £850 billion

- **At the end of 2009, the UK government's interventions to support banks comprised:**
  - **Guarantees:** £450 billion to ensure banks remained liquid
  - **Insurance:** covering £280 billion of assets owned by Royal Bank of Scotland
  - **Share purchases:** £69 billion - Royal Bank of Scotland and Lloyds Banking Group
  - **Loans:** £62 billion to support banks and protect depositors.....
  - Less £14 billion in fees and interest

# Audit work to date 1: reports to UK Parliament

## Timeline

## Financial audit

## Performance audit

**July 2008**

HM Treasury financial statements for 2007-08, including nationalised assets and liquidity support

**March 2009**

Nationalisation of Northern Rock \*

**July 2009**

HM Treasury financial statements for 2008-09, including wide range of: contingent assets and liabilities; derivatives; financial assets

**December 2009**

Maintaining Financial Stability Across the UK Banking System \*

**July 2010**

HM Treasury financial statements for 2009-10, including complex accounting for asset protection

**December 2010**

- Asset Protection Scheme \*
- Update report on maintaining financial stability \*

**March 2011**

Stewardship of the wholly-owned banks; buy back of subordinated debt

\* Indicates hearings before Committee of Public Accounts

# Audit work to date 2: reports to UK Parliament

Timeline	Financial audit	Performance audit
<b>July 2011</b>	HM Treasury financial statements for 2010-11, including the financial stability interventions	
<b>November 2011</b>	Whole of Government Accounts (WGA) – first audited set of accounts showing in one place the financial position of the whole UK public sector. *	
<b>May 2012</b>		The creation and sale of Northern Rock *
<b>July 2012</b>	HM Treasury financial statements for 2011-12, including wide range of: contingent assets and liabilities; derivatives; financial assets; and introduction of quantitative easing. *	
<b>July 2013</b>	HM Treasury financial statements for 2012-13, showing reduction in government guarantees, increase in quantitative easing, and use of new lending schemes.	
<b>December 2013</b>		First sale of shares in Lloyds Banking Group Helping consumers to manage their money
<b>February 2014</b>		Regulating Financial Services
<b>June 2014</b>	Fourth Whole of Government Account - showing extent of government support schemes and impact on the financial crisis on government borrowing - as well as the government's cost reduction programmes.	

# The strategic and operational challenges for the NAO

- The environment presented us with:
  - Huge opportunity for strategic development
  - Increased risk for the NAO
- We faced 3 operational challenges:
  1. Coherent programme of work on crisis response
  2. Work in the new area of financial regulation reform
  3. Developing our capacity
- Internally, our response has been to transform the way the NAO works. In line with our own advice to government, we have applied NAO's guide on Structured Cost Reduction to achieve efficiency and cultural change with focus on skills and expertise. *More on this later.*

# We developed a coherent programme of further work on crisis response

- Why this mattered:
  - Huge ongoing exposure for taxpayer
  - Crowded space
  - Crisis response measures served different objectives:
    - System-wide stability: liquidity and guarantees
    - Individual recapitalisation measures
    - Asset work-out schemes
  - Providing certainty to Parliament, Government and markets

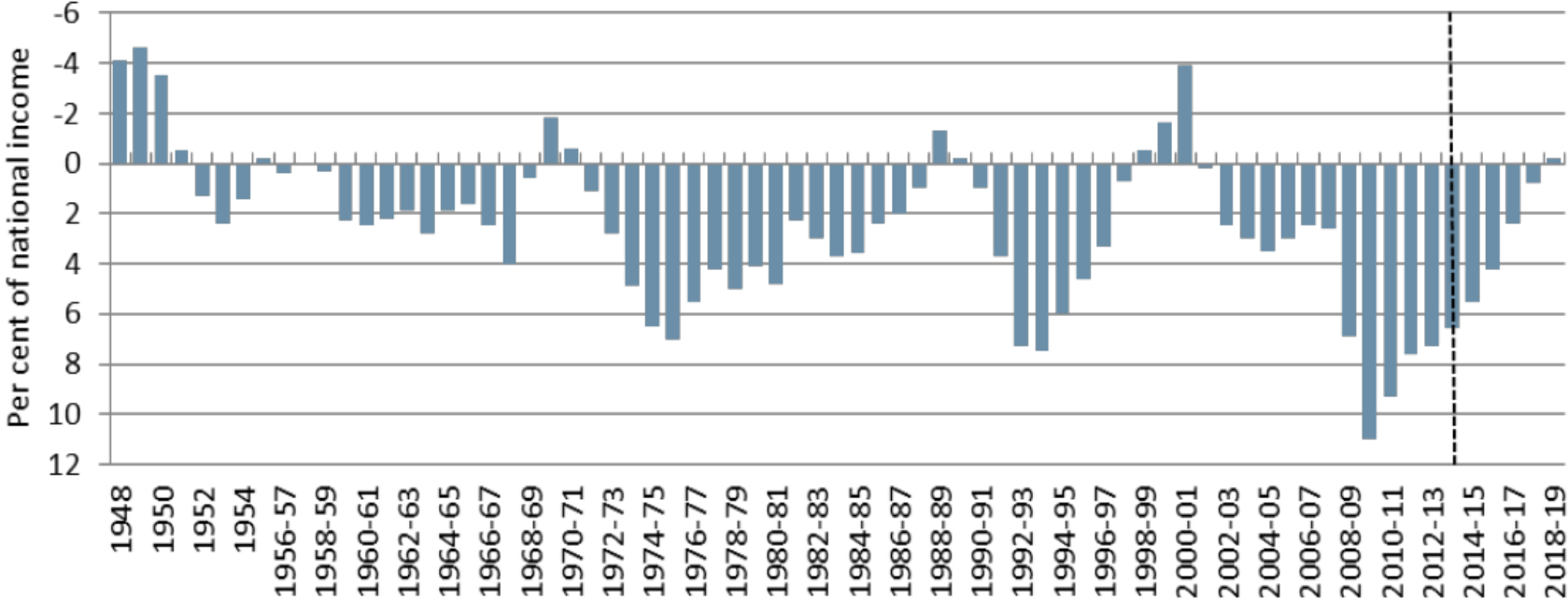
# We developed a coherent programme of further work on crisis response (continued)

- Annual overviews of the taxpayer's overall position
- Further focussed/transactional reports:
  - For individual institutions, at point of exit (e.g. sale of shares; sale of business)
  - For asset-based schemes, report on ongoing management
  - For liquidity & guarantee measures, only if and when Government risk increases (for example, from a return to severe market distress)
  - Programme of work on regulation of the financial sector



# UK fiscal surpluses and deficits

Public sector net borrowing since 1948



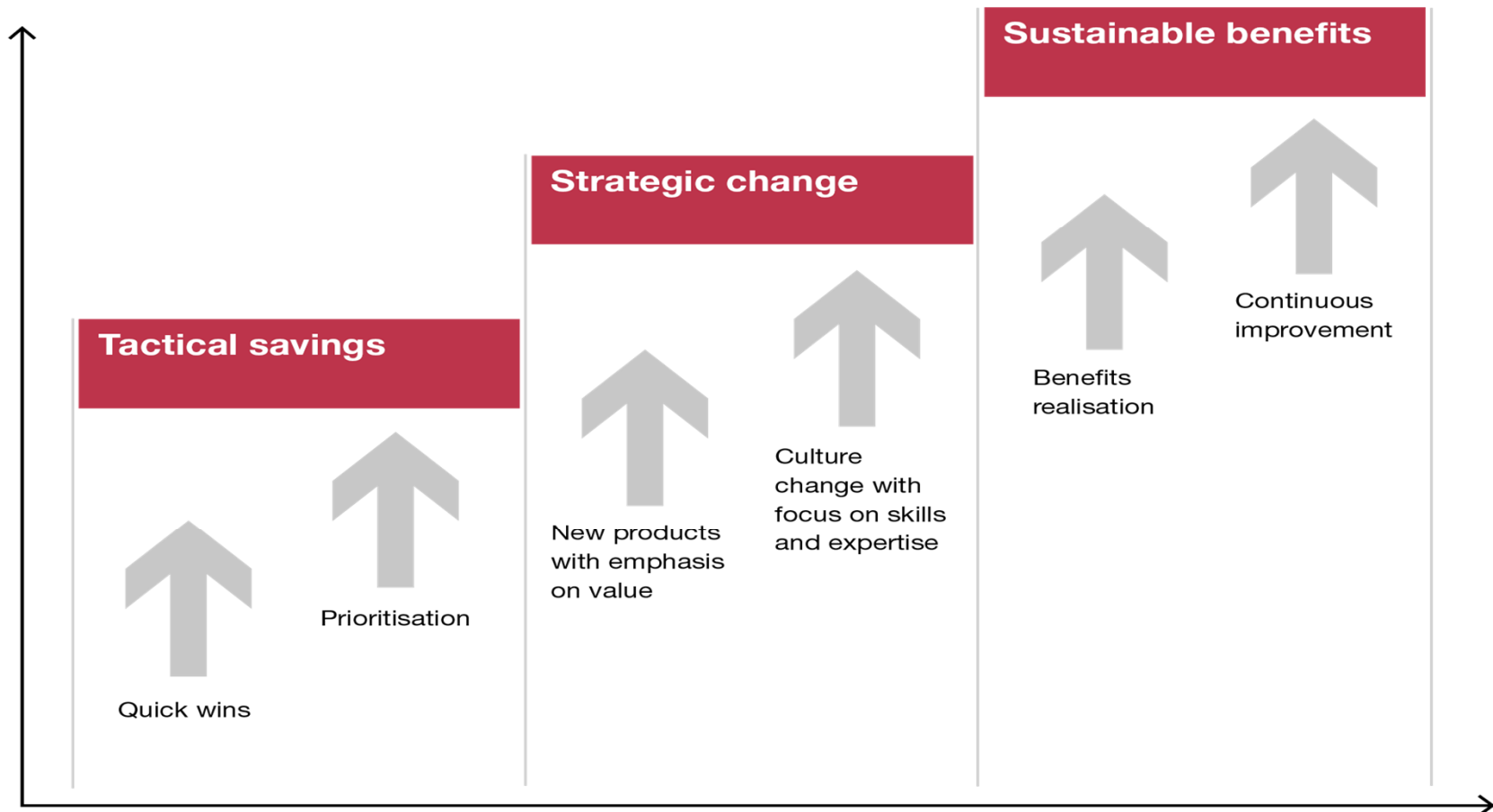
Source: Office for Budget Responsibility <http://cdn.budgetresponsibility.org.uk/37839-OBR-Cm-8820-accessible-web-v2.pdf>

# Structured cost reduction

- The UK public sector faces continuing austerity. The low-hanging fruit is long gone, so reduced funding is driving change in how local and national government are organised, and how services are delivered. Skills in strategic planning and change management are at a premium.
- The pace of economic recovery means that the UK government has extended fiscal consolidation further than originally planned in the 2010 spending review. While there are now signs of recovery, output has only now returned to its pre-recession level in 2008. The government has forecast continued reductions in departmental spending to 2017-18, signalling further cuts beyond the election in May 2015 and the next Parliament.
- The NAO has not escaped the pressure to reduce costs. The scale of cost reduction required has meant that we, like government departments, have had to look beyond immediate short term savings and think more radically about how to take cost out of the business and how to sustain this longer term. This has required strong leadership, disciplined financial management and a corresponding change in organisational culture. In our case, it has led to NAO's transformation.

# The NAO Response

## Stages of cost reduction / transformation



# Working Cost-Effectively

## Key facts

17%

reduction in our resources since 2010-11 baseline

20:80

ratio balance between our business support costs and front-line activity

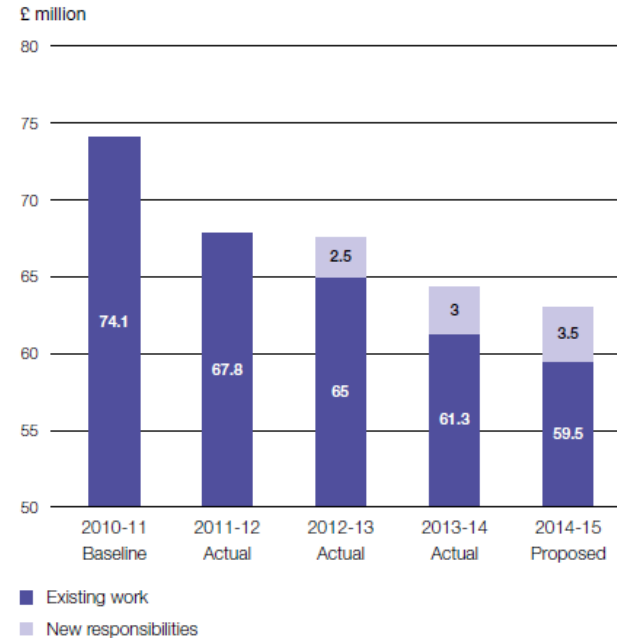
We use funds cost-effectively. In keeping with our commitment to practise what we preach, since 2010-11 we have undertaken an ambitious cost reduction programme. Against our baseline of existing work, we have reduced our resources by 17 per cent in cash terms (22 per cent after allowing for the effect of inflation). We maintain an appropriate balance between our business support costs and front-line activity. We ensure these are within the ratio of 20:80 per cent.

We continue to take cost reduction seriously and our budget for 2014-15 is a further 5 per cent reduction on our 2013-14 budget for existing work (7 per cent inflation adjusted). Although we are reducing our resources, this is managed carefully through transforming the way we work, and we have continued to improve the quality of our work and become more responsive to emerging issues. We are doing more with less.

Source: NAO Annual Report 2014

## Overview of the NAO's progress on cost reduction

### NAO's net resources



### Notes

- 1 Our baseline was set at £74.1 million in 2010-11.
- 2 Does not include ring-fenced restructuring costs of £4.2 million in 2013-14.

# The NAO's Transformation

- We have changed how we work to better address the key strategic issues facing the UK government, which are likely to have the most impact on the public sector's long-term performance.
- We are working in a more joined-up way, grouping our audit teams into six clusters. Each focuses on a key strategic issue shared by some of the bodies we audit. This enables us to better compare how these issues are being addressed by sharing the lessons learned, and deepens our expertise to ensure our work is relevant and timely.
- We launched our transformation programme in 2013 to achieve a significant increase in our contribution to improving public services. So far the transformation programme has put us in a better position to deliver sustained value to those we audit, and improved assurance to Parliament. We presented NAO's transformation at the EUROSAl workshop on 17 June entitled "*the increasing relevance of SAIs in the 21<sup>st</sup> Century – the experience of the UK National Audit Office*" – (insert link)

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