



Cynulliad Cenedlaethol Cymru The National Assembly for Wales

Y Pwyllgor Cyfrifon Cyhoeddus The Public Accounts Committee

**Dydd Mawrth, 16 Hydref 2012
Tuesday, 16 October 2012**

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Motion under Standing Order No. 17.42 to Resolve to Exclude the Public

Cofnodir y trafodion yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir trawsgrifiad 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

Yr Athro/Professor David Heald	Prifysgol Aberdeen University of Aberdeen
Amyas Morse	Rheolwr ac Archwilydd Cyffredinol y DU UK Comptroller and Auditor General

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

Sarah Beasley	Clerc Clerk
Joanest Jackson	Cynghorydd Cyfreithiol Legal Adviser
Sarah Sargent	Dirprwy Glerc Deputy Clerk

Dechreuodd y cyfarfod am 9.02 a.m.
The meeting began at 9.02 a.m.

Cyflwyniad, Ymddiheuriadau a Dirprwyon
Introduction, Apologies and Substitutions

[1] **Darren Millar:** Good morning, everybody, and welcome to today's meeting of the Public Accounts Committee. The National Assembly for Wales is a bilingual institution and people are free to contribute to today's meeting in either English or Welsh as they see fit. Everybody has a headset; they are available for amplification and translation, should you require it, during the course of the meeting. I encourage everybody to switch off their mobile phones, pagers and BlackBerrys as they can interfere with the broadcasting and other equipment. In the event of an emergency, follow the instructions of the ushers, who will guide people to the nearest appropriate exit. We have not received any apologies for absence. We will move on to the meat of our agenda.

**Bil Archwilio Cyhoeddus (Cymru): Cyfnod 1—Tystiolaeth gan yr
Athro David Heald**
Public Audit (Wales) Bill: Stage 1—Evidence from Professor David Heald

[2] **Darren Millar:** We are continuing with our scrutiny work on the Public Audit (Wales) Bill at Stage 1. We are taking evidence today from Professor David Heald. This is the third oral evidence session that we have had on the Bill. Welcome, Professor, and thank you for your paper, which we are very grateful for. If I may, I shall go straight into a question, but feel free to add any opening remarks in your response. Do you agree with the need for legislation in this area, and do you agree with the principles behind the Bill as they stand?

[3] **Professor Heald:** It depends what you mean by ‘the principles behind the Bill’; if you are asking whether I believe in having accountability, transparency and good governance in a public audit office, then obviously the answer is ‘yes’. However, I think that the Bill as it stands is fundamentally misguided. It reflects what happened in the United Kingdom Parliament, where they used a sledgehammer to crack a nut. The issue in the United Kingdom was largely about the expenses of a former Comptroller and Auditor General, but a complex system was set up to deal with that particular problem. Although I am not familiar with Welsh public affairs, from what I have read in the extensive documentation that I have seen, Wales is going down the same way.

[4] There are things that can be done to achieve those objectives. In my evidence, I propose a clear separation at the Assembly between the client role that this committee would perform and the oversight role that is performed by the Public Accounts Commission in the United Kingdom Parliament and the Scottish Commission for Public Audit in the Scottish Parliament. I propose the establishment of a Welsh commission for public audit. I believe that oversight belongs clearly to the legislature; that is where oversight should lie. There should not be any ambiguity about the responsibilities of the Auditor General for Wales. If I were a member of this committee, one of the things that would worry me is that future Auditors General for Wales would not be able to be as frank with the committee as they could otherwise have been, because they will have to defend a rather complex compromise that has been effected within the board.

[5] Therefore, although I am all in favour of better internal governance, the crucial point is that the Assembly should either trust the Auditor General for Wales or remove the Auditor General for Wales. There are proper protections for the independence of the Auditor General for Wales because you need a two-thirds majority of all Members voting for such removal. Obviously, in a proportionally representational parliament, that actually gives a very good protection.

[6] **Darren Millar:** We will tease out some of the detail of your responses to some of those issues, such as the corporate body, in a few moments. However, I would like to get a very clear statement on the record. Do you think that we need legislation to be able to deal with the governance and oversight issues that need to be addressed?

[7] **Professor Heald:** Most of the issues can be dealt with without legislation; they could be dealt with internally in the Wales Audit Office. Where I think you will need legislation is to set up a Welsh commission for public audit. There could be a committee of the Assembly to deal with oversight, which is the position in Northern Ireland—rather confusingly, it is called the Audit Committee of the Northern Ireland Assembly. However, I think that there is an advantage to having a statutory body for two or three reasons. One reason is that it will probably not suffer the turnover of membership during a term of the Assembly that can happen to select committees. I noticed in the report of your previous committee that there had been a lot of turnover even within the last term of the Assembly. At Westminster and in

Scotland, the statutory body does not fall at dissolution; it continues. Think about what happened in the Westminster Parliament after May 2010: at a time when key executive decisions were being taken by a new Government, there were no committees functioning; they did not really get established until July, just before the long Parliamentary recess. Therefore, having a continuing body is one of the advantages. It would also flag up the separation of the client role from the oversight role. Also, one of the things that I propose is that, if you have a statutory body, you could think about having external members with expertise. Therefore, there are some things you would want legislation for, but that would not be the present Bill.

[8] **Darren Millar:** Thank you very much for that. Julie is next.

[9] **Julie Morgan:** Can you tell us a bit more about how the Scottish system operates and your views on it?

[10] **Professor Heald:** Although I am a professor in a Scottish university, I would not claim to be very familiar with the detailed operations in Scotland. However, I was a member of the Financial Issues Advisory Group that made the recommendations that became the Public Finance and Accountability (Scotland) Act 2000, which basically set up the system. Scotland had a complex situation whereby, before devolution, we had the Accounts Commission, which dealt with local government and health audit, and the National Audit Office in Scotland, which was part of the UK National Audit Office. At the time, there was a big discussion about whether you should keep a separate body for local government audit, reflecting the separate democratic mandate of local authorities. What FIAG proposed and Parliament accepted was that Scotland was too small a country to have two audit bodies.

[11] Turning back to the situation in Wales, one of the practical problems Wales has had is that, in the six years after devolution, there was not a full-time auditor general for Wales, and the merger of the Audit Commission in Wales and the National Audit Office in Wales did not take place until 2005. One thing that came out in the international peer review was that that merger did not go particularly well, and that there were a lot of legacy issues connected with that merger. However, to come back to Scotland, Scotland had a chance of settling down its arrangements right at the beginning of the existence of devolution. Generally speaking, the view in Scotland would be that that merger went successfully for staff at the Accounts Commission and the National Audit Office in Scotland. Because of FIAG, Scotland actually has that clear distinction between the client role that takes the Public Accounts Committee role and the oversight body that is actually responsible for governance. The point that I am trying to emphasise is that I think that the client role and the oversight role are fundamentally different. I think that the oversight role belongs to the Assembly, or the Parliament in the Scottish case, and not to complex internal mechanisms.

[12] **Julie Morgan:** I think that you mention in your evidence that the fact that we have only 60 Members could be a determining factor. Do you wish to add anything on that?

[13] **Professor Heald:** In Scotland there are 129 Members and in Northern Ireland there are 108 Members; so, Wales actually has a very small legislature. However, that would not discourage me from taking the view that one wanted a statutory body with a very clear oversight role that was recognised, that would not be subject to the kind of turnover that select committees often have, and that would actually survive dissolution. There would probably be a stronger argument in Wales for having external members because, obviously, as a committee of the Assembly one cannot have external members, whereas if it is a statutory body, the Act could state that there would be a certain number of statutory members, with the Members of the Assembly being in the majority.

[14] **Julie Morgan:** The Members of the Assembly should be in the majority.

[15] **Professor Heald:** I think so.

[16] **Julie Morgan:** Yes.

[17] **Professor Heald:** There is this fundamental point that public audit should belong to the legislature. It is symbolic rather than a matter of great importance, but it is signalling the fact that the prime responsibility and route of accountability of the auditor general is actually to the Assembly, not to the Government.

[18] **Aled Roberts:** You obviously have reservations about setting up the Wales Audit Office as a separate entity. You have mentioned the board comprising executives and non-executives, but what other changes do you feel should be made with regard to the whole concept?

[19] **Professor Heald:** As I said at the beginning, there is a danger of overreaction in Wales, in the same way that there was an overreaction in Westminster. The other point to make is that Wales is a very small country, when you consider the size of Wales in relation to that of the United Kingdom. At the United Kingdom level, with a much bigger National Audit Office than the Wales Audit Office, you can get away with making it very bureaucratized and complicated, having the corporation sole model of the auditor general at the statutory board, and then a code of practice to govern relationships between them. I think that there is a real danger in Wales of the system becoming so complex and bureaucratized that it attracts all the attention to the internal processes of the audit office and not to the substantive work. There has obviously been a loss of trust in Wales because of the problems that you have experienced. If you had a Wales commission for public audit, with concerns expressed in the explanatory memorandum, and if the change is in internal governance to the WAO, an auditor general could just abolish the changes of the present auditor general, and my view would be that that would be extremely risky for a future auditor general for Wales if there was a Wales commission for public audit, because obviously the Wales commission for public audit would want to ensure that there was proper internal governance

9.15 a.m.

[20] The whole point about public audit is that its independence is fundamentally important. If you establish a corporate structure with powers to control the resources available to the auditor general, you run the danger of damaging that audit independence. If I were a member of this committee, I would be worried about whether tensions were building up between the board and the Auditor General for Wales. The chair of the board and the auditor general would not particularly want to share those with the committee, and then you would get a crisis.

[21] **Aled Roberts:** You mentioned your view that putting a corporate board on top does not encourage confidence and, in fact, weakens the whole system.

[22] **Professor Heald:** Exactly. I would prefer, as a not very desirable option, abolishing the corporation sole status of the Auditor General for Wales and just making it a corporate body. I think that that is a bad idea, but it gets away from the idea that you have one governance mechanism, which is corporation sole, and you have another on top, a board, and that makes it better. I think that they would largely negate each other, and if you are to continue with the present model, you will need a statutory code of practice, which comes back to my point about bureaucratizing the whole process.

[23] **Aled Roberts:** You also state in your evidence that you believe that the Government is placing too much confidence in reasonableness as a mechanism for resolving

disagreements. What is your view of section 26, which allows the WAO board to reject all or part of the auditor general's work programme?

[24] **Professor Heald:** First of all, I do not know what 'reasonable' means. 'Reasonable' in this context could be determined only by the courts. If the auditor general tried taking the Wales Audit Office board to court, it would bring the whole system and the Assembly into disrepute. It is difficult to determine what is reasonable and what is unreasonable in that context, except through a court of law. It is taking away the power that the auditor general needs as a corporation sole to discharge his responsibilities to the Assembly, by not allowing him to come to the Assembly with a request for resources. So, there are two things to note: one is that I do not know what 'reasonable' or 'unreasonable' means; and, secondly, if the Auditor General for Wales is not delivering what the Assembly wants, it becomes very confusing as to whether it is because the Auditor General for Wales has not been given sufficient resources, or whether it is the fault of the board. There is an inherent conflict in the board in the sense that it is supposed to be holding the auditor general to account while at the same time controlling what resources the auditor general gets. My argument is that it should be the Assembly that decides how much the auditor general gets, in response to a bid from the auditor general, so that the auditor general is satisfied with the resources that the Assembly has provided. That should be quite clear.

[25] **Mike Hedges:** Could you expand on paragraphs 11 and 12 of your submission, which appear to suggest that the Wales Audit Office should be advisory rather than supervisory? From my experience of serving on a lot of public bodies, I feel that there is a variation from those such as local councils through to those such as health authorities, where you have a mix of people who are either executive or non-executive, and then, with something like a police authority, not only do you have an overarching body, but you actually have a split in roles. Do you see a police authority model being appropriate?

[26] **Professor Heald:** I confess that I know very little about police authority models. The point that I would make to start is that the question of the auditor general and public audit is actually very different from a public service delivery organisation in police or in health, for example. The auditor general has to make judgments on financial certification audit, and he has to make judgments on value for money, and the whole model of public audit collapses if the auditor general's independence in those judgments is reduced.

[27] The other point to make is that there is a lot of discussion about the different models of board. My argument is that an advisory board should be there to give advice to the auditor general, but the auditor general would be perfectly entitled to reject that advice. By definition, 'advisory' means drawing in expertise from outside, which might be international, academic, or from the private profession. However, the auditor general makes the decisions. So, the Public Accounts Committee and the Welsh commission for public audit would be clear that the buck stops with the auditor general.

[28] On the model in the Bill, quite a few people who have submitted written evidence to the committee have made the point that you have a supervisory-type composition for executive tasks, and one should not overstress the similarity between what is proposed in Wales and the case in the United Kingdom Parliament. In the United Kingdom Parliament, there are five non-executives, including the chair, and four executives, who are essentially there on the basis of the preferences of the Comptroller and Auditor General. So, it is five to four with a non-executive majority, but the Comptroller and Auditor General and his management team clearly have a very strong role. What has been proposed in the Bill, namely five non-executives, one employee, and the auditor general, is a strange composition for an executive board. In response to an earlier question, my worry is about this mixing of monitoring and advising. If a board advises the auditor general on actions, it cannot at the same time monitor and hold him to account. The roles are fundamentally in conflict.

[29] **Mike Hedges:** Is there not a problem with advisory boards? I can tell you now that if I were on an advisory board and I gave my advice once and it was ignored, and I then gave my advice again and it was ignored again, I would say, 'Thank you very much, I am wasting my time and yours, goodbye'. Is there not a danger with advisory boards that, if the advice is not taken, the advisory board will just fall apart?

[30] **Professor Heald:** There is obviously that kind of danger. That goes back to my earlier point about a loss of trust. However, if you remember the example of the Welsh commission for public audit, that is precisely the kind of question that you would ask that commission. A wise auditor general would be well prepared to ensure that, if advice came from the advisory board, which he or she did not accept, a good reason was given for that. Your example presumably implies that not only was your advice not followed, but you did not think that there was any kind of due process about that advice.

[31] **Mike Hedges:** No. If my advice had not been followed, having given it twice, I think that I would say, 'Thank you very much, but we are wasting each other's time'. I do not think that it is to do with due process. If I have come to a viewpoint, and that viewpoint has been ignored twice, it would not get ignored a third time. I think that a lot of people would feel the same way.

[32] **Professor Heald:** Obviously, you can have successful and unsuccessful advisory boards. However, in this specific instance, what I am saying is that it is fundamentally important to make it absolutely clear that responsibility lies with the auditor general. If the advisory board suggests that there should either be more or less attention paid to the NHS in Wales, it should be for the Auditor General for Wales to make that decision, and to defend that decision to the Public Accounts Committee, when you are dealing with reports, and to the oversight body.

[33] **Jenny Rathbone:** I want to pursue this idea that people on advisory boards get ignored. You will be aware of the dictum that power corrupts and absolute power corrupts absolutely. Therefore, in your scheme of things, where would the responsibility lie for dealing with the sorts of issues that, unfortunately, have arisen with previous auditors general, both in the UK and in Wales, where people have not behaved to the highest standards of the Nolan principles? Would that be the role of the advisory body or of the Welsh commission for public audit?

[34] **Professor Heald:** That would be the role of the Welsh commission for public audit.

[35] **Jenny Rathbone:** Okay. You can see the difficulty. The Welsh commission for public audit would be made up of people who would not be a part of the Wales Audit Office and they would rely on evidence from other people if they felt that the office was being abused.

[36] **Professor Heald:** You are raising a number of separate issues.

[37] **Jenny Rathbone:** They are crucial in the minds of people who are worrying about how previous auditors general abused their power.

[38] **Professor Heald:** There was certainly inappropriate behaviour in the past, but expectations and standards have changed about what is acceptable practice. On unacceptable behaviour, there is a great danger in focusing on what are thought to have been the misdemeanours of a former Auditor General for Wales, as that is only part of the story. On the basis of what I have read, particularly the international peer group report, followed up by the internal audit review by the Wales Audit Office, which ought to have been externally

commissioned and not done internally, it is clear that there were lots of senior management conflicts within the Wales Audit Office. I would put it more bluntly than the peer review did—although, if you look at page 35, it is pretty clear. The peer review group told senior management to get its act together and stop fighting, and it drew attention to a bad human resources climate in the Wales Audit Office and to a poor industrial relations record. There were serious big-sense housekeeping problems. The housekeeping side of governance was not done well, either on the human resources side or on the financial management side. As I said in my memorandum, reading the National Audit Office report on the accounts from 2005 to 2012 is very depressing, as is looking at the Auditor General for Scotland's report to the Assembly on the 2010-11 accounts. However, some of those problems reflect the problems of merger. When you have made mistakes, particularly if you are an audit office, it is very difficult to correct them without serious problems.

[39] Having said all that on the negative side, the crucial point about the peer review is that it tells a good story about the operational activities of the Wales Audit Office. Given that it was created only in 2005 as a merger of two bodies, one of which had its own legacy bodies, it gives a good report on its operational work. One has to remember that the UK National Audit Office really has its origins in Gladstone, so it is a body that has been around for a very long time. The picture that the peer review gives is of a body that functions very well on an operational level but that has let its internal housekeeping fall. On your question of who would be responsible, given that there is much more sensitivity about expenses after the House of Commons' problems and other problems, it is very clear that there are certain issues that a governance organisation at a parliamentary level would have to deal with.

[40] I understand the concerns that have been generated, but I am worried about damaging the credibility and operational performance of public audit because of certain things that have happened in the past. If I were on the Welsh commission for public audit, I would want to know from the present Auditor General for Wales whether the internal senior management problems had been solved. One thing that seems to have happened after 2005 was that people had legacy entitlements from previous employment outside the control of the Auditor General for Wales and, if you had wanted to reorganise senior management and remove certain people, you would have had to pay them very large amounts of compensation, which would have been extremely newsworthy. So, I can understand why there is a reaction to what happened, but, because the operational performance is praised, one has to be careful that one does not enter a situation where, essentially, housekeeping concerns—on which an audit body must do well or it will come into disrepute—will affect the operational side.

9.30 a.m.

[41] The other point is that you cannot expect governments to like public auditors, because they sometimes qualify their accounts and say critical things about public services and how they are run. There becomes a danger that, when a public audit organisation has problems, as here, governments will clamp down. One only has to look at what has happened in England, where the Audit Commission was abolished largely because it upset some powerful people. It is interesting that, with the peer review, the Wales Audit Office kept its stakeholders on board. I gave evidence to the Communities and Local Government Committee at Westminster about the Audit Commission, and it was striking, at that time, that all the stakeholders had turned on the Audit Commission. The audit functions have now been outsourced to private firms. In contrast, in 2009, before the scandals broke, the Wales Audit Office had the support of its stakeholders.

[42] **Jenny Rathbone:** That still does not address the top-line concern about where the personal behaviour of the officeholder brings the office into disrepute and how that is going to be dealt with. I am a bit concerned that the Welsh commission for public audit will be peopled by Assembly Members and the great and the good, who may not know of the

concerns that may be about the behaviour of the officeholder. That is what seems to have been a cause for concern in the past.

[43] **Professor Heald:** You cannot legislate for criminal behaviour by any public official, particularly if the criminal behaviour is not connected with the direct conduct of duties. The severance-type issues were an internal failure of the processes within the audit office. I would attribute that, much more than seems to have been done by many of the documents I have seen, to the inherited problems of the merger and distrust within the senior management. In your scenario, it is not obvious that even the corporate board would know what was going on. One issue in Wales, as a small country, is the question of proximity. Given the fact that the Auditor General for Wales under the present Bill would be on his or her own within the corporate board, I wonder where these five people will come from. I would have thought that, in a country the size of Wales, with the issue of people being seen to have political baggage or professional conflicts of interest, one could easily end up with a corporate board that knows remarkably little about Wales.

[44] **Darren Millar:** One suggestion that has been made by a number of witnesses is that, rather than having a corporate body, a supervisory-type board should be established, which will be a little closer to the action, as Jenny has suggested, so that it can keep its eye on the ball more easily, perhaps, than a lofty statutory body, which might be one step removed from the day-to-day activity of the Wales Audit Office. Would that be a more appropriate model?

[45] **Professor Heald:** If you are asking me whether the National Audit Office model is less bad, the answer is 'yes'. I have difficulty with this terminology of 'supervisory board'. If it is about internal governance, you have the high-level housekeeping that is fundamental for all public bodies to get right, but even more so for audit offices. I understand that. However, if it is a body that is monitoring, in my view, it cannot, at the same time, advise or have executive-type functions. If it is advising or having executive functions and it is monitoring, it becomes very unclear whether any issues that arise are because of the actions of the auditor general or the actions and decisions of the board. One of the things that I think would happen is that it would drive the debate away from the Assembly.

[46] **Darren Millar:** So, if we take away all executive functions of the board and simply have a supervisory board, to which the auditor general is held to account, is that not a sufficient way of safeguarding the independence of the auditor general and some of those other concerns that you raised?

[47] **Professor Heald:** If it was clear that the question of resources was in the hands of the auditor general and there was not a corporate board model with executive functions, I think that that would go part of the way. However, I still make the point that the crucial oversight role of public audit should belong to the legislature, not to the executive.

[48] **Mohammad Asghar:** Thank you for the wonderful information that you have given us. Scotland and Wales are both small countries.

[49] In paragraph 12 of your submission you suggest that the Auditor General for Wales should be trusted with strengthening internal control arrangements. Would such arrangements be sustainable in the long term, particularly as a successor AGW could unpick any such arrangements that have been put in place on a voluntary basis?

[50] **Professor Heald:** I mentioned earlier that I think there has been a collapse of trust. What people seem to want to do is put lots of rules and regulations in place. If you look at the Budget Responsibility and National Audit Act 2011, and at Schedule 3 and the code of practice, you will see that there is quite tight specification about how a relationship should actually work, which is a view that 'rules are what you want', rather than 'principles are what

you want'. So, if you have a lot of trust, there is a temptation to invent a lot of rules. I make two points: first, I think that that is misguided; and, secondly, you should also think about the different scales of the Wales Audit Office and the National Audit Office—something you can make work at the National Audit Office level, which is a pretty big organisation, might be much more difficult and consume much more senior management time at the Wales Audit Office level.

[51] In answer to the question about a future auditor general unpicking arrangements, given the fact that I would want the Welsh commission for public audit to have a leading role in the appointment of future auditor generals, and it would be the body by which the auditor general is held to account, I think that this unpicking danger is just exaggerated, because there would be safeguards at the Assembly level.

[52] **Darren Millar:** I suppose the issue is the existing arrangements. On the one hand you are saying, 'Trust the auditor general to make sure that there are sufficient safeguards within his own organisation and have this relationship of trust'. We know, for example, that our current auditor general has taken steps to improve accountability and oversight within the organisation, as it were, but those committee arrangements that he has set up on a voluntary basis do not have a statutory basis. Therefore, if a new AGW is appointed, he could just tear them up and throw them out of the window and say, 'I am not having any of this anymore. I am my own person, I am independent and I can do what I want.' Is there not a danger of that if you extend the trust situation perhaps too far?

[53] **Professor Heald:** If you are seriously worried on that point, there is no reason why something should not be put into the legislation. I was proposing legislation for the Welsh commission for public audit. You could put something in, but the problem is that using primary legislation to specify organisational structures strikes me as intrinsically undesirable. If the loss of trust has reached such a point that people feel that it is necessary, I do not think it is that damaging.

[54] **Darren Millar:** Julie, you wanted to come in.

[55] **Julie Morgan:** You said that you felt that a collapse of trust should not result in rules and regulations being put in place. That seems to me to be an absolutely natural progression: if there is a collapse of trust you try to do something about it in a way that will stop that from happening again. I would challenge what you are saying there.

[56] **Professor Heald:** I am a professor of accountancy, and, in accounting, one usually makes the distinction between the UK system, which has always been based on trying to set high-level principles, and the US system, which is based on incredibly detailed rules that take up an amazing number of pages. The problem with detailed rules is that they can paralyse the system and they also encourage people to find ways of getting around them. A lot of the issues, such as in the case of Enron in the United States of America, were caused by the fact that you had the rules, and provided you could do something within the rules, then that was fine. People invested an enormous amount of time and resources into finding ways of complying with the rules, but still getting the result that they wanted.

[57] **Darren Millar:** We do not have time to go into the ins and outs of Enron. You have contrasted a number of times the size and scale of Wales with the scale of the UK National Audit Office arrangements. I think you suggested that the NAO arrangements are working.

[58] **Professor Heald:** That is a question best addressed to the Comptroller and Auditor General when you see him this morning.

[59] **Darren Millar:** So, you are not able to give us your professional opinion.

[60] **Professor Heald:** No, presumably the Comptroller and Auditor General is not going to come to Cardiff and tell the Welsh Public Accounts Committee that the system in the UK is not working.

[61] **Darren Millar:** But I am looking for your opinion. Do you think that it works on an NAO level?

[62] **Professor Heald:** I have no inside knowledge whatsoever. There is an issue that I raised when the UK Bill was being considered originally in 2008-09, namely that there is a danger that governments try to exercise political influence through the kind of people that they put on the corporate board. There are two points to make in that regard. First, that is probably less of a threat at a United Kingdom level because of the 4:5 composition of the corporate board, and, secondly, there is the fact that the United Kingdom is a much bigger place, which means that it is much easier to find suitable people who will not either have conflicts of interest or politics or be perceived to have them.

[63] **Darren Millar:** Of course, you are assuming that everybody appointed to any board has to be from within Wales.

[64] **Professor Heald:** You could have a board that does not have anybody who knows anything about Wales. That is the danger.

[65] **Darren Millar:** There are plenty of people from Wales who know a lot about Wales living elsewhere around the world. However, we will move on because you are talking very specifically about the composition of the board and I know that Lindsay has some questions about that.

[66] **Lindsay Whittle:** Good morning. Paragraph 17 of your submission, Professor Heald, says that

[67] ‘Employee representation on an executive Board which exercises control over the AGW is entirely inappropriate. There are specific issues in the context of an Audit Office that do not apply to a normal public service delivery organisation.’

[68] What are those specific issues? You have cited in your evidence examples, such as industrial relations, human resource issues and possibly the finger of suspicion pointing at an executive member in case of any leaks, but was there anything else?

[69] **Professor Heald:** The key issue is audit independence and the status of the Auditor General for Wales as a corporation itself. You mention the practical kind of issues that I raised, but my understanding of UK arrangements is that the three people on the NAO board, other than the Comptroller and Auditor General, are there with his or her approval. The employee member is going to be chosen either by the board or through some democratic election of employees of the Wales Audit Office. The issues of audit independence become particularly important given the Wales Audit Office board’s control of the resources available to the auditor general.

9.45 a.m.

[70] **Lindsay Whittle:** You mentioned that you have some difficulty with supervisory boards, and that is coming across—

[71] **Professor Heald:** I have difficulty with regard to exactly what people think they will do. That is what I am saying. The supervisory board is German for the higher level board

above the executive board. So, if you are going to go for a supervisory board model, it has to be very clear what the supervision is about. To come back to the question on the concern about internal governance and good practice, that is quite different from having control over resources and work programmes.

[72] **Lindsay Whittle:** Do you, with your experience, have any thoughts on the appropriate size and composition of any board?

[73] **Professor Heald:** It depends what that board is going to do.

[74] **Lindsay Whittle:** I meant in relation to Wales.

[75] **Professor Heald:** For an executive board, the balance in the UK is a much better balance—the 5:4 balance—but the numbers might be too big in the context of Wales. However, if it is going to be an executive model, it requires much stronger presence, because the employee member is presumably not a person who would necessarily be the choice of the Auditor General for Wales if unconstrained. If it was the unconstrained choice of the Auditor General for Wales, I would assume that an assistant auditor general would be chosen. That would be a natural choice, because it would be a member of senior management. If you have an advisory board, there is scope. I do not think that that is the kind of thing that I would want to pin down in primary legislation, but you could certainly have people from the private accountancy profession, people from academia, people from another audit office in another jurisdiction, or someone from private business.

[76] **Lindsay Whittle:** Would that be your advice to this committee?

[77] **Professor Heald:** My advice would be to have an advisory board and to have a Wales commission for public audit.

[78] **Aled Roberts:** You referred to the supervisory board perhaps not being in the tradition of public audit in the UK, and you mentioned that it is more akin to a German model. When we heard evidence from the unions, they cited the German model, where there is employee representation, as something that they supported. Do you have any knowledge of the continental model, where there may be employee representatives who are not, as you have stated, the choice of the auditor general?

[79] **Professor Heald:** My knowledge of German corporate governance is limited to what I read in newspapers. However, my understanding is that the German model is to have an executive board that has a supervisory board of wider stakeholders, but the executive decisions are clearly reserved to the executive board management level.

[80] **Jenny Rathbone:** I would like to go back to discuss the employee member of the Wales Audit Office board. My concern about the auditor general appointing a staff member to the board is that person could be constrained in what they could say because it might affect their status as an employee, whereas someone elected by the staff of the WAO would not have that problem, because they would have a mandate from the staff to represent the views of the organisation. If they found that the heat was getting a bit too much, they could always resign and someone else could be selected. The point is that it has to be someone who is not beholden to the auditor general for their position on that board—whether it is advisory or supervisory. I appreciate that, were it to be supervisory, they would have to absent themselves from any decisions about cutting staff levels, and so on, because that could compromise their position. However, where we are talking about good governance and the duties of the organisation, I would have thought that that a member elected from among the staff would be entirely appropriate, given that all of these people are supposed to have the Nolan principles running through them like a stick of rock—at least, I would hope so.

[81] **Professor Heald:** For the reason that I gave previously, I do not think that an employee member of the board of an audit office is appropriate. Leaving that aside, if you are going to have an employee member, and that means not someone who is from senior management—

[82] **Jenny Rathbone:** It could be a senior manager; we do not know.

[83] **Professor Heald:** However, if your employee member is not, ex officio, an assistant auditor general, then election is a better model than choice. I still think that that person will be in an exceptionally difficult position. One of the points that should worry people is that the international peer review commented extensively about the poor industrial relations record of the Wales Audit Office and about weak human resource management practices. I would have thought that an elected employee member would be in an extremely difficult position, because there will be a question about that person being there in a representational role, to represent the employees as stakeholders, while, at the same time, having collective responsibility as a member of a board with executive functions. So, I think that that arrangement will build tensions and problems.

[84] **Jenny Rathbone:** Supposing that the role was not supervisory and did not involve taking executive decisions, but rather was advisory, would it not be perfectly possible for that to be an enhancement of the good governance of—

[85] **Professor Heald:** If it was advisory, yes.

[86] **Jenny Rathbone:** Okay. Thank you. I want to quickly ask you about the issues that you raise in paragraph 18 about the legacy costs and the payoffs—I know that you have already mentioned this. I am having difficulty understanding how this could ever be an issue, but, clearly, it has been an issue. You are saying that, if we were to disband the current organisation and create a new board, we could have this problem all over again.

[87] **Professor Heald:** I do not understand the taxation law or the employment law side of it, but, from what I have read, the issues are that, when you have two corporate bodies, with one providing services to the other corporate body, that could be regarded as a taxable transaction in terms of travel and subsistence.

[88] There is also the question of the terms on which people transfer. The union evidence that I have read expresses concern that it is not clear whether it is TUPE, the Transfer of Undertakings (Protection of Employment) Regulations 2006, or TUPE equivalent. That is entirely out of my scope of expertise, but the point that I was making was that that is a transitional cost that should be thought about very carefully before legislation is enacted, because it could be extremely embarrassing. One of the things that clearly happened—I think that the Audit Commission had two predecessor bodies and people had their rights transferred in and then transferred into the Wales Audit Office as a non-corporate body, but, if they are transferred into a new corporate body, you could end up with all those kinds of problems. It also reduces flexibility. You can imagine becoming a new auditor general for Wales and thinking that your senior management is top-heavy, but not feeling able to do anything about it, simply because the severance costs would be so large, and that is a sensitive topic.

[89] **Darren Millar:** Thank you very much for that. The clock has beaten us, Professor Heald—pardon me, Gwyn, did you want to ask a question?

[90] **Gwyn R. Price:** In conclusion, on the establishment of a Welsh commission for public audit, your first statement was ‘Either back the auditor general or don’t have one’, is that—

[91] **Professor Heald:** No, back the auditor general, or remove the auditor general if the auditor general loses the confidence of the Assembly. In Westminster, you can remove the Comptroller and Auditor General by a resolution of both Houses of Parliament. That is exceptionally difficult, so there is an in-built protection. In the context of a unicameral system like Wales, the fact that it is by a two-thirds majority of total Members and you have proportional representation gives a big protection. However, if there was a clear sense in the Assembly that the auditor general should be removed, the Assembly should remove the auditor general.

[92] **Darren Millar:** On that note, we will close this part of our meeting. Thank you very much indeed for your evidence, Professor Heald.

[93] **Professor Heald:** Thank you very much.

9.55 a.m.

**Bil Archwilio Cyhoeddus (Cymru): Cyfnod 1—Tystiolaeth gan Reolwr ac
Archwilydd Cyffredinol y DU
Public Audit (Wales) Bill: Stage 1—Evidence from the UK Comptroller and
Auditor General**

[94] **Darren Millar:** Okay. We will take evidence now from Amyas Morse. Have I pronounced that correctly?

[95] **Mr Morse:** Yes.

[96] **Darren Millar:** Amyas Morse is the UK Comptroller and Auditor General. We are delighted to have you here with us today, and you are here to talk a little about the workings of the National Audit Office and how the board side of things, in particular, works over in the UK Parliament. We are very grateful that you have come in to share your experience of that. As you know, we have a Bill before us that will constitute some similar arrangements, I think it is fair to say, to those which exist in the National Audit Office. One of the things that we have been concerned about is that a number of witnesses have suggested that the sort of arrangement that is on the face of our Bill could potentially leave an auditor general feeling fettered and constrained as far as his independence was concerned. Is that your experience?

[97] **Mr Morse:** It has not been my experience under the arrangements we have in the National Audit Office. You should bear in mind that I have never operated under any other arrangements because, although there was no statute in place when I was appointed, there was a clear intention to enact the statutory provisions. I knew what they were and I agreed before hand that I would be happy to work with them, so we had them. Although technically I was not subject to that, we conducted all our business as if the statute was in place. So, from the start, we acted on that basis in good faith, and, to be honest, although I do not necessarily recommend it to yourselves, it was not a bad way to start because it meant that everybody started off behaving in a way which said, 'We know what the arrangements are supposed to be and we are going to try to put our best possible efforts into making them work as well as they can'. So, the fact that it was a voluntary arrangement, while knowing it was going to become statutory, let us work out the arrangements, code of conduct and everything else in a relatively relaxed fashion.

[98] **Darren Millar:** Do you think that without that code of conduct you would perhaps feel more fettered or not have the opportunity to express a very clear audit opinion at times?