

The forthcoming Constitutional Renewal Bill will transform the National Audit Office into a corporate body with a board and chair, a potentially damaging move believes David Heald

Compared with the US congress, the UK parliament is weak in financial matters, a contrast emphasised by their respective roles during the world financial crisis. Bereft of powers of decision-making, the UK parliament must rely on its powers of scrutiny to hold the executive to account.

Fortunately, the St John Stevas reforms of the early 1980s strengthened parliament in two important ways. First, the comprehensive coverage of departmental select committees has become an established part of the parliamentary landscape. Second, after a long public debate between parliament and the executive, the National Audit Act 1983 was passed. The Exchequer and Audit Department was transformed into the National Audit Office (NAO), with the benefit of increased resourcing and a broader remit that facilitated the development of value-for-money (VFM) audit.

However, the Constitutional Renewal Bill in the next session will include provisions that, if enacted, would seriously weaken the independence of the comptroller and auditor general (C&AG), the head of the NAO. Although governments might be suspected of wishing to weaken the NAO, one of parliament's most effective tools, these proposals have been put forward by the Public Accounts Commission, the statutory body that exercises oversight of the NAO on behalf of parliament.

The Tiner review and the legislative proposals

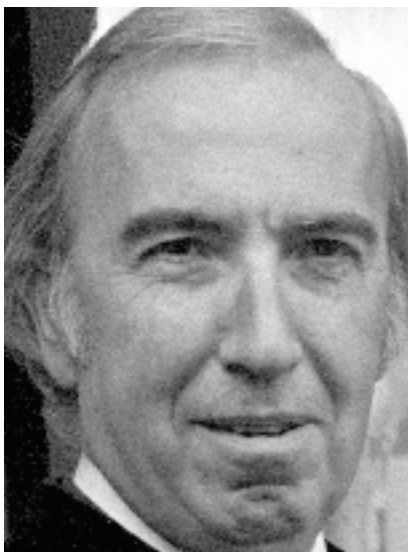
Media reports, originating in *Private Eye*, alleged abuse of expenses by Sir John Bourn, then the C&AG. The following controversy gathered momentum, leading the Public Accounts Commission to publish a special report on the C&AG's expenses on 7 July 2007 and announce a review of NAO governance.

That review, by Mr John Tiner, former chief executive of the Financial Services Authority, was published on 6 February 2008 followed by the Commission's response on 4 March and draft legislation prepared by the NAO for the Commission on 21 July.

This flurry of reporting indicates how all-consuming the issue had become; the Commission's normal reporting practice has been every two years, with no general report since January 2005.

Given the terms of reference and Tiner's

A MUZZLED WATCHDOG



Norman St John Stevas' reforms helped to make the NAO what it is: will his good work be spoiled?

predominantly private sector experience, the recommendation of a corporate structure, with a board having a non-executive majority, was predictable. The non-executive directors will be nominated by the chair of the NAO and approved by the Public Accounts Commission. Currently, the NAO is not a corporate body, and the C&AG is an officer of parliament, not an employee of the NAO. The C&AG is a 'corporation sole', a status which allows him or her to enter into contracts and which facilitates the transfer of responsibility from one incumbent to the next.

The proposed restructuring of NAO governance is precipitate and an over-reaction. The momentum that developed about expenses convinced the Public Accounts Commission that something structural 'had to be done'—ironically, parliament imitating what governments often do when things

go wrong. What those giving evidence to Tiner recommended is not in the public domain. However, it is clear that parliament through the Public Accounts Commission rather than the executive has driven the structural reform agenda.

Applications for the posts of chair of the NAO and C&AG closed on 20 October 2008, ahead of legislation. Appointments might be made before parliament debates the merits of this structural reform.

A proper diagnosis

Notwithstanding the way in which Sir John Bourn's tenure ended, the 1988-2008 period during which he shaped the modern NAO can be seen in a positive light. The NAO coped well with the transition of government accounting from cash to accruals in 2001-02 and seems well prepared for the 2009-10 transition to international financial reporting standards.

It has demonstrated a willingness to resist government pressure where it believes this is justified by the quality of its work: a notable example has been its insistence on on-balance treatment of most PFI schemes when it is the auditor. It has developed VFM auditing in a way that is well regarded internationally.

Moreover, the international audit work of the NAO contributes to the UK interest in more efficient and effective international institutions, and its consultancy, advice and training work is a valuable projection of British 'soft power'.

What went wrong could be remedied by modest but well-targeted measures. First, Sir John Bourn's 20-year tenure was excessively long, reflecting a weakness in the 1983 Act; one consequence is that all senior management had been appointed by him, and were likely to leave before he did. They may not have felt able to counsel him on matters of probity and appearance. With hindsight, the Public Accounts Commission should have addressed the succession issue. This may

have been inhibited by fears of encroaching on the independence of the C&AG and perhaps also by there being no retirement age or term limit for members of parliament.

Second, the system for approving and controlling the expenses of the C&AG appears to have been lax, though it may have been in line with systems then prevailing elsewhere in Whitehall for permanent secretaries. There may have been a link between lax controls on expenses and the perception that the C&AG's salary (£159,058 in financial year 2006-07) did not match his responsibilities. Despite some hypocrisy in media coverage of the C&AG's expenses and acceptance of hospitality, there were grounds for serious concern.

There does not appear to have been an institutional mechanism for dealing with the problem, either before it went public or after it became a matter of public controversy. This shock to the NAO's confidence, together with the de facto temporary nature of the appointment of the present C&AG (Tim Burr, the former deputy), may have led the NAO to accept recommendations in the Tiner Report which it would otherwise have resisted.

Paradoxically, the unfettered personal authority of the C&AG, a vital protection against encroachment on independence, itself became the problem in the context of personal conduct.

What is wrong with the legislative proposals

First, the combination of C&AG (non-renewable ten-year term) and chair of NAO (once-renewable three-year term) is misguided. The proposals duplicate governance mechanisms (corporation sole and corporate body), rather than choose between them. Certainly governments could exert pressure behind the scenes on the chair in ways that cannot presently be applied to the C&AG. Even without explicit government pressure, a strong chair might interfere with the running of the NAO (e.g. insisting on more outsourcing of audit work to the private sector or undertaking fewer VFM studies), leaving the organisation split and uncertain.

A weak chair would be a distraction or an irrelevance. The existence of a chair, perceived to be 'senior' to the C&AG, might be taken as a signal of diminished authority and responsibility, and thereby weaken the attractiveness of the post of C&AG.

Second, the draft legislation contains complicated provisions seeking to balance the independence of the C&AG with the role of the newly created NAO board and chair. Some examples indicate what would be involved.

- The C&AG 'must take into account the strategy prepared by the NAO under

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paragraph 17 of schedule 1 (clause 2(6)). This wrongly assumes that it is possible in a state audit office to separate responsibility for strategy from that for operations.

- Responsibility to prepare an estimate for the NAO has been allocated to the board rather than to the C&AG. This removes a crucial link between the C&AG and the Public Accounts Commission, whose chairman presents the NAO estimate to parliament.

- The 'employee' members of the NAO board are to be appointed by the non-executive members rather than by the C&AG (schedule 2, part 3, clause 10). This reduces the authority of the C&AG over senior colleagues.

- A code of practice will contain 'any restrictions to be placed on non-executive members of the NAO about the public comments they may make in relation to the carrying on of any of the functions of the Comptroller and Auditor General' (schedule 3, clause 4(f)). That code will also provide for the way in which resources are to be allocated for the C&AG's 'statutory' audits and examinations and the way in which the C&AG obtains the approval of the NAO to carry out 'non-statutory work'. Having to run the NAO on this code of practice means that the C&AG has lost control of the allocation of the NAO's resources and makes conflicts of authority likely.

Third, what will the non-executive majority on the NAO board actually do with their time? If they are knowledgeable they will be tempted to interfere. If they are not, they will distract NAO top management from running its business. And, like the chair, their renewable appointments will make them a possible conduit for ministerial interference.

What should be done now

Instead of inappropriate structural changes based on a pre-conceived corporate sector model, procedural adjustments are needed, some of which will require legislation.

First, a term limit for the C&AG is

definitely required, though how long this should be raises difficult issues. Tiner suggested eight years and the Commission proposed ten in the draft legislation; either of these limits seems reasonable. Retirement ages written into statute might fail on legal grounds. Moreover, appointing someone relatively young raises the possibility of resignations before the end of the term, which means that provision has to be made for an acting C&AG.

Second, the pay of the C&AG, linked to that of a high court judge, is much too low in relation to salaries in some other public sector jobs and in private auditing. This then constrains salaries down the NAO's professional hierarchy. Pay is obviously a sensitive issue but there is evidence from financial regulation of the dangers of regulators being paid less than those they regulate: the same applies to parliament's watchdog.

If there is to be a statutory comparator, the Lord Chief Justice would be more appropriate than a high court judge or permanent secretary. Generous remuneration whilst in post should be accompanied by the strongest legally permissible restrictions on subsequent employment, together with an absolute bar on any other remuneration whilst in office. Sir John Bourn surprisingly accepted in March 2006 the paid post of independent adviser on ministerial interests, a role protecting the Blair government.

Given the obvious sensitivity, an effective audit committee needs to ensure that internal regulations covering expenses, hospitality and external activities are comprehensive, clear and complied with. The chair of the audit committee should be authorised to report concerns directly to the chairman of the Public Accounts Commission.

Third, the Commission requires modest extra resources and should then operate like the statutory body it is and less like a select committee (e.g. with members coming in and out of meetings because of commitment clashes). Members sometimes confuse their oversight role (Public Accounts *Commission*) with their client role (Public Accounts *Committee*), and a clearer delineation is necessary.

In 1983 there was a huge parliamentary debate about the creation of the NAO, whereas these changes are proceeding without debate. Moreover, the oversight of the NAO is a matter of democratic accountability, for which an NAO board cannot substitute. There is still time to avoid unintended injury to the NAO.

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