THE PUBLIC AUDIT (WALES) BILL

Memorandum by Professor David Heald to the Public Accounts Committee

INTRODUCTION

1. I am grateful to the Committee for the opportunity to submit written evidence and then give oral evidence. Introducing myself, I am Professor of Accountancy at the University of Aberdeen Business School, with a longstanding research interest in public expenditure, public sector accounting and auditing. My practical engagement with these matters includes being:
   • specialist adviser on government accounting to the Treasury Committee of the House of Commons (1989-2010)
   • member of the Financial Issues Advisory Group which proposed the financial arrangements that were later enacted as the Public Finance and Accountability (Scotland) Act 2000 (1998)
   • specialist adviser to The Public Accounts Commission of the House of Commons (TPAC) (2002-08)
   • member of the Audit Commission’s Technical Advisory Group (2003-2010)
   • independent member of the Financial Reporting Advisory Board to HM Treasury, on the nomination of the UK Government’s Chief Economic Adviser (2004-09)

2. It is relevant to the present matter that I resigned as specialist adviser to TPAC in July 2008, so that I could publicly oppose the corporate model for the National Audit Office (NAO) that had resulted from the Tiner Report (2008). My criticisms of the audit governance arrangements that were later enacted by the Budget Responsibility and National Audit Act 2011 are expounded in Heald (2008, 2009). I later gave written and oral evidence to the Communities and Local Government Committee of the House of Commons, opposing the abolition of the Audit Commission and the complete outsourcing of local government and National Health Service (NHS) audits in England (Heald, 2011).

3. I lack personal knowledge of Welsh public affairs and of the difficulties that have led to the provisions in the Public Audit (Wales) Bill. I am therefore heavily dependent on my
reading of publicly available material. However, there are generic issues about public audit arrangements that deserve consideration by the Committee. My concern is that the Bill proposes a permanent structural solution to a temporary conduct problem, for which there are proportionate remedies. ‘Something has to be done’ often leads to policy and institutional design mistakes.

**THE CHALLENGES OF PUBLIC AUDIT**

4. Public audit constitutes a difficult arena because it extends much further than the financial certification audit also undertaken in the private sector. Judgements about ‘regularity and propriety’ and Value for Money (VfM) are central to the substance of modern public audit. VfM audit inevitably touches sensitive nerves in the triangular relationship between Legislature, Government and Audit Office. While VfM does not question policy, the line between what is policy and what is implementation is inevitably blurred. The issue of cost effectiveness (does the policy achieve declared objectives?) sits alongside that of worth-whileness (which is of fundamental interest to legislators and their electors but which Audit Offices address with difficulty). VfM audit comes behind policy implementation, so there is always the danger of wisdom derived from hindsight. Moreover, media and political attention will inevitably focus on criticisms, disregarding successes, thus creating an aura of negativity. Public audit is a delicate plant which has to be carefully nurtured.

5. In this difficult context, the actual and perceived independence of an Auditor General are fundamental safeguards. In his/her work, an Auditor General must have independence not only from the Government but also from the Legislature because reports may include criticism of expenditure programmes and organisations that have strong support in the Legislature. There should be an open appointments procedure, a fixed term of between seven and ten years, restrictions on subsequent employment to the extent that the law allows, and a well-defined procedure for removal from office.

6. Auditors General are ‘Officers of Parliament’, constitutional watchdogs of fundamental importance to democratic government (Gay and Winetrobe, 2008; Gay, 2011). The need to protect independence makes this role an isolating experience, thereby emphasising the importance of support arrangements that do not impinge on professional judgement.
7. In governance terms, the accountability of the Auditor General for Wales (AGW) should be to the Assembly as a whole, not to the Government or the governing majority. My reading of documentation in relation to the **Public Audit (Wales) Bill** is that the Government is in the driving seat, not the Assembly (Welsh Government, 2012, para 40). This is dangerous because Governments, at both ministerial and civil service levels, have incentives to constrain the operations of public audit.

**PROBLEMS AT THE WALES AUDIT OFFICE**

8. The reputation of the Wales Audit Office (WAO) was damaged by the events of 2010 and 2011 (Public Accounts Committee, 2011). My reading persuades me that it would be wrong to attribute all the responsibility for this damage to the criminal conduct and managerial style of Mr Jeremy Colman, AGW from April 2005 to February 2010.

9. Among the points that emerge from the publicly available documentation are the following:

   (a) Mr Colman’s term of office was extended in May 2009 so that he would serve an eight-year term, an indication of Assembly confidence in his record-to-date as the first full-time AGW

   (b) The International Peer Review (Gardner et al, 2009) gave a generally positive appraisal of the professional work of the WAO in October 2009, four and a half years after its creation. However, in both explicit and coded language, it noted dysfunctional relationships among senior management and an unsatisfactory human resources and industrial relations climate. While highlighting multiple challenges ahead, it rejected adoption of the corporate model then newly adopted by the NAO ahead of legislation. It recorded strong stakeholder support for the WAO, in marked contrast to stakeholder responses to the announced demise of the Audit Commission

   (c) The Internal Audit report (Wales Audit Office, 2011) on the conduct in office of Mr Colman is written in a hostile tone, criticising many aspects of his managerial style but making no reference to the context within which he was operating. In light of the signals about conflict among senior management contained in the International Peer Review (Gardner et al, 2009), it is regrettable that this report was not externally commissioned
(d) The National Audit Office (2010) report on the WAO accounts from 2005-06 to 2009-10 makes dismal reading. This led to restatements in the 2010-11 accounts and a report to the Assembly by the Auditor General for Scotland (AGS) (Black, 2011). While in no way excusing the egregious accounting and disclosure deficiencies at the WAO, the audit fees to a private firm in those years were minimal: £8,000 (2005-06); £9,000 (2006-07); £9,000 (2007-08); £10,000 (2008-09); and £13,000 (2009-10). Not only are there exaggerated expectations of what financial certification audit can achieve but also top-tier audit firms do not bid for such work because they have, or may bid for, contracts with Audit Offices as outsourced audit suppliers. There are dangers in audits of Audit Offices being undertaken by audit firms without extensive experience of the specific requirements of HM Treasury’s Financial Reporting Manual. Audits of each other by Auditors General might be seen as a round robin. Robust internal review, including the technical department of an Audit Office, is therefore imperative: material errors once made will later lead to reputation-shredding restatements of accounts.

10. On the basis of my reading, I conclude that:

(a) the integration of NAO in Wales and Audit Commission in Wales was problematic; to what extent difficulties were ones of managerial and employee culture, professional judgement or incompatible personalities is something on which others might advise the Committee. The legacy of entitlements from previous employment will have complicated changes in senior management, not least in that departures would be expensive and controversial. Whereas Audit Scotland and the AGS were established in 1999,¹ when there was a halo around devolution, the WAO and full-time AGW were not created until 2005; this may have been a complicating factor. Hopefully, the present AGW will be able to resolve legacy issues

(b) the impression is given of a large amount of time being spent on the internal machinery of public audit, possibly to the detriment of the delivery of public audit

¹ The AGS is an office holder of the Scottish Parliament, appointed by Her Majesty, but not a corporation sole. Audit Scotland is a corporate body, whose statutorily defined membership is: the AGS; the Chairman of the Accounts Commission; and three other members appointed jointly by the AGS and the Chairman of the Accounts Commission (Public Finance and Accountability (Scotland) Act, Section 10(2)).
(c) proportionate internal governance mechanisms for the WAO are available, rendering the corporate model unnecessary as well as inappropriate

(d) Assembly oversight of the AGW and WAO should be strengthened.

PROPORTIONATE REMEDIES

11. The independence of the AGW, in fact and in appearance, from the Government and the Assembly, is vital. The incumbent has three roles: corporation sole as AGW; Chief Executive of the WAO; and Accounting Officer. There are tensions between these roles which the incumbent must manage. In his written and oral evidence, the AGW has documented the ambiguities, tensions and inflexibilities that would arise from the proposed corporate board structure (Thomas, 2012). The arrangement confuses governance with executive functions, and oversight with advice. I could understand a proposal to abolish the corporation sole status of the AGW (though I would oppose it), but putting a corporate board on top is not strengthening governance but weakening it. In this case, two mechanisms are not better than one but risk the dilution of accountability.² Boards can be oversight, executive or advisory. If the WAO is to have a board, this should be advisory, with executive authority in the hands of the AGW and oversight exercised by the Assembly (see paragraph 14 below). Advice should be given careful consideration, but the decision-making authority, together with accountability for decisions, should rest unambiguously with the AGW.

12. I support what is labelled as Option 2 (Allow AGW to strengthen internal control arrangements) in the Explanatory Memorandum (Welsh Government, 2012). Although events make this a difficult point to sustain in public debate, the internal management of the WAO should be his/her responsibility. An Audit Office in a parliamentary democracy is not like a normal public sector service delivery organisation because of the paramount importance of protecting audit independence in relation to financial certification, regularity and propriety, and VfM. The roles of monitoring and advising do not mix. In my view, the proposals which the AGW put to the Committee on 7 October 2010 largely address the identified deficiencies (Wales Audit Office, 2010a,b).

² In the case of the corporate NAO, Schedule 3 of the Budget Responsibility and National Audit Act 2011 governs the relationship between the NAO and the Comptroller and Auditor General. This requires a Code of Practice (National Audit Office, 2012).
There is an update in the 2011-12 Wales Audit Office (2012, pp. 64-65) Report and Accounts.

13. The AGW should have a fixed, non-renewable term and there should be a clearly specified mechanism for removal from office for misconduct or under-performance. This power must be exercised by the Assembly as a whole and be subject to a strong super-majority requirement that protects the incumbent from removal by the Government of the day. In the bi-cameral UK Parliament, the requirement is a resolution of both Houses and in the unicameral Scottish Parliament, elected on proportional representation, a two-thirds majority of all members. Given that conflicts between the Government of the day and the AGW can be predicted, such protection is essential. Within the assurances provided by the statutory framework and oversight arrangements, the Assembly should trust or remove the AGW.

14. The accountability of the AGW should run directly to the Assembly. There is a distinction between the oversight role (exercised at Westminster by TPAC) and the client role (the Westminster Public Accounts Committee (PAC) is the principal client of the NAO). During my 2002-08 specialist advisership, I felt that TPAC, whose active members were often also PAC members, tended to blur its oversight role with the more familiar client role. However, I agreed with the procedure through which TPAC approved the Corporate Plan and Estimates, and then the Chairman of TPAC presented the NAO’s Estimate to Parliament and answered Parliamentary Questions. The Scottish Parliament follows the Westminster arrangement, with oversight being by the statutory Scottish Commission for Public Audit consisting of Members of the Scottish Parliament. I understand that the small size of the Assembly at 60 Assembly Members (AMs) may have been a reason for not establishing a separate oversight body in Wales. However, the roles of client and oversight body that the Public Accounts Committee must presently fulfil can be incompatible. I therefore propose the establishment of a Welsh Commission for Public Audit, which might include a minority of external persons with relevant governance and financial knowledge and experience. There

3 The post of Comptroller and Auditor General of Northern Ireland was established by the Government of Ireland Act 1920. The present arrangements are described at http://www.niauditoffice.gov.uk/index/about-nia/governance-of-nia.htm. There is an Advisory Board whose role is ‘providing objective and impartial advice to the C&AG to assist him in the discharge of his functions’. In the Northern Ireland Assembly, the client role is performed by the Public Accounts Committee and the oversight role is performed by the Audit Committee.
should be some overlap of membership with the Committee but those AMs should not dominate.

**SPECIFIC POINTS ABOUT THE MODEL OF THE CORPORATE BOARD**

15. The Government is placing too much confidence in reasonableness as a mechanism for resolving disagreements and conflicts between the AGW and the WAO. This is not something that could credibly be tested in the courts and, if it were, it would inflict reputational damage, provoke media mockery, and probably lead to resignations. Conflict might arise over:

- how much VfM audit and performance measurement to undertake (note the drastic curtailment for local authorities and the NHS in England)
- which areas of public expenditure should receive priority for VfM
- resource requirements
- the extent of reliance on outsourced audit providers, rather than the use of WAO employees (note the abolition of the Audit Commission and the outsourcing of its audit functions)

Instead of speaking his or her mind to the Committee, the AGW might have to defend unsatisfactory compromises. This would be done in the knowledge that disagreements might leak to the media or be disclosed through Freedom of Information (FOI) requests.

16. I have no knowledge of how the NAO arrangements are working. However, I would point to the proximity factor that affects public audit in the smaller polities of the Devolved Administrations, where there is more intense Legislature-Audit Office interaction than at Westminster. This intensifies the danger of compromising the AGW’s independence, or of such perceptions arising. In a small country like Wales, suitable candidates for Non-Executive roles will be well-known and could become subject to media, governmental or political pressure.

17. 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. Such a Board member would also be seriously conflicted: for example, in relation to the industrial relations and human resources issues identified as problematic by the International Peer Review (Gardner et al, 2009), and to future reductions in workload and employment. If there
were leaks from the Board or ‘inspired’ FOI requests, suspicion might be pointed at the employee director.

18. In his written and oral evidence the AGW (Thomas, 2012) has raised a number of practical obstacles to the implementation of the corporate board proposal (eg HM Revenue & Customs treatment of travel and subsistence expenses and the legal basis on which staff transfers would take place from the AGW to the corporate WAO). The resolution of these issues would have significant impacts on transition costs. Indeed, even without legislative change, legacy entitlements of staff from predecessor organisations will constrain the managerial freedom of the AGW. This might cause future controversy because of ‘pay-offs’, the amounts of which would be beyond the control of the AGW and WAO.

CONCLUSION

19. The International Peer Review (Gardner et al, 2009, p. 7) wrote of the WAO being at a watershed, in part due to expected reductions in financial audit work as machinery of government changes reduced the number of audited bodies. The reality has proved much more difficult.

20. Media criticism of the expenses of the then UK Comptroller and Auditor General were the trigger for the corporate model being applied to the NAO. Rolling out a corporate model is a readily available option and the Budget Responsibility and National Audit Act 2011 constitutes a precedent. In my view, this model is inappropriate for Wales.

21. Auditors should not expect to be popular, especially public sector auditors whose remit extends to VfM and organisational performance at a time when UK fiscal austerity is putting downward pressure on Welsh public expenditure. Public sector organisations are inevitably exposed to media and political attacks on, for example, salaries and expenses. Good housekeeping is desirable for its own sake and imperative for reputation because of easy media headlines about ‘public sector fat cats’. However, the point needs to be made that the full-year salary of the present AGW in 2011-12 was £150,000 (Wales Audit Office, 2012, pp. 56), about 20% of the mean salary of a Big 4 audit partner.
22. Rather than going ahead with this Bill, the Assembly should pass a limited measure which includes the establishment of a Welsh Commission for Public Audit. Legislation would not be required to establish an Advisory Board to advise the AGW in the discharge of his/her responsibilities, but it could be given a statutory basis. In the context of public audit arrangements, the AGW and WAO remain in the early years of their existence. The overriding need is to provide the AGW with the support he/she needs while being clear that this does not dilute either his/her independence of professional judgement or personal accountability to the Assembly for the performance of the WAO.

Aberdeen, 2 October 2012

References


Public Accounts Committee (2011) Accounting, Governance and Propriety Issues at the Wales Audit Office, March, Cardiff, National Assembly for Wales.

Public Audit (Wales) Bill [as introduced], 9 July, Cardiff, National Assembly for Wales.


Wales Audit Office (2010b) *International Peer Review of the Wales Audit Office – Update to the Public Accounts Committee*, 7 October, Cardiff, Wales Audit Office.

Wales Audit Office (2011) *Review of the Former Auditor General for Wales, Mr Jeremy Colman’s, Conduct in Office*, 8 February, Cardiff, Wales Audit Office.
