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C(82) 42

COPY NO 83

14 December 1982

CABINET

PARLIAMENTARY CONTROL OF EXPENDITURE (REFORM) BILL

Memorandum by the Chancellor of the Exchequer

1. Mr Norman St John-Stevas's Private Member's Bill is down for Second Reading on 28 January. It is intended to implement the recommendations of the Public Accounts Committee (PAC) in their First Special Report of 1980-81. (Other Committees had previously made similar recommendations.) The main principles of the Bill are that the appointment of the Comptroller and Auditor General (C&AG) and his staff should not be in the Government's hands, and that the range of the audit should be "wherever public money goes" - in particular to include the nationalised industries and many public companies.
2. In the Government's Reply (Cmnd 8323) to the Report we accepted the need for new legislation to update the statutory description of the C&AG's functions; but were not convinced of the immediate need for the radical changes proposed by the PAC. Following an adjournment debate on 30 November 1981 an Early Day Motion collected nearly 300 signatures in favour of the PAC's recommendations. We have since been discussing minor concessions (within existing legislation) with Messrs Barnett and du Cann and others following discussion in E Committee on 9 February 1982.
3. The initiative is, however now with Mr St John-Stevas. Although he has asked for co-operation in drafting the legislation, he is determined to proceed, with the support of the movers of the Early Day Motion. He is confident that his Bill will command very wide support; and the Lord President believes that this confidence is not misplaced. Our White Paper arguments were and are sound, but we cannot now expect that a majority in Parliament will accept them as overriding the constitutional argument about accountability which dominates their thinking. I believe, therefore, that we should now concentrate on seeking to negotiate with Mr St John-Stevas and his associates a specification for the Bill which will be sensible and workable, and minimise the adverse consequences of moving too far in the direction urged by some of the extremists, and if we can negotiate a specification, we should offer the services of Parliamentary Counsel to help with the drafting, working to agreed instructions. This will give us a much better chance of influencing the Bill, and ending up with a tolerable piece of legislation, than would be likely if we wait for the Bill to be presented in the form currently proposed by Mr St John-Stevas, and then attempt piecemeal amendments against the mood of the House.

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INDEPENDENCE OF THE C&AG AND HIS STAFF

4. The C&AG is at present an office holder under the Crown, appointed on the advice of the Prime Minister who consults the Chairman of the PAC. His staff are civil servants of the Exchequer and Audit Department. Changing the manner of his appointment could involve constitutional considerations, though the adoption of a procedure whereby the recommendation to the Crown came from a Commission, consisting of the Prime Minister and the Speaker, would not in itself be damaging. What is important is that we should not concede that the C&AG and his staff should become employees of the House. They would then become liable to directions from the House which could include any of its Committees. That would raise serious problems about their access to the Government's files.

5. I believe we must seek to ensure the independence of the C&AG and his staff both from the Government and from Parliament (other than by Act of Parliament). The national audit should be conducted as a professional operation with proper audit objectives; it should not be made to react to particular and transient interests of Members or Parliamentary Committees or the Press. The C&AG could not, of course, ignore representations made to him - from Government as well as others - but the decision on what he and his staff should do should be his and his alone.

6. On that basis it should be acceptable that he should retain his present powers of access to papers which have, by consent over many years, allowed not only for statutory certification audit but also for value-for-money and effectiveness studies. C&AG investigations, and PAC examinations, have always scrupulously avoided policy issues: they have been audit-based, ie concerned with past, not future, expenditure. This must remain the case; for on any other basis we could easily find ourselves obliged to impose, and defend, restrictions on access for particular investigations.

7. I attach at Annex A an outline of new arrangements for the Appointment and Status of the C&AG which would I believe be satisfactory for Government: it remains to be seen whether they would satisfy the House.

SCOPE OF THE AUDIT

8. Annex B deals fully with the position of the nationalised industries. The arguments against involving the C&AG there and in such companies as BL, Rolls Royce, etc are sound, but my judgement is that they will not carry the day, against the appeal of the simplistic PAC formula of "following public money wherever it goes". I, therefore, think we must now concentrate on how far, rather than whether, this should be accepted.

9. As regards the nationalised industries, I suggest the following:

a. Access to the books of nationalised industries should be through a separate branch of the proposed National Audit Office, to consist of staff with adequate qualifications and experience to understand the commercial scenario in which they operate. The Monopolies and Mergers Commission should be withdrawn except for monopoly inquiries as for the private sector.

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b. Studies in the nationalised industries should follow a systematic programme determined by the C&AG in consultation with the Government and the industries.

10. The British Technology Group (BTG) is already in an anomalous position - the Exchequer and Audit Department (E&AD) audits the National Research Development Council side of its activities - and I suggest we should concede access to all its books (but not the books of companies in which it has an interest).

11. For private sector companies, I should prefer to confine access to those where the Government has a controlling interest (BL, Rolls Royce and possibly Cable and Wireless). There will be pressure to extend this to other companies where the Government holds shares, either directly (British Aerospace, Britoil, BP) or through BTG - but these are commercial concerns and we should resist E&AD crawling over their business if possible. There will also be pressure to "follow public money" into other companies which receive substantial assistance in grants, loans or guarantees, eg the £200 million guarantee to ICL. Again we should resist this if possible - but at worst I should want to try to find some way of distinguishing these cases of substantial selective assistance from the ordinary run of small-scale or automatic grants (Regional Development Grants, agriculture, and so on). This negotiating position is summarised in Annex C, and the fall-back position is set out at Annex D.

OTHER MATTERS

12. Other issues on which I believe we should seek to agree with Mr St John-Stevas and his backers are also listed in Annex C.

CONCLUSION

13. A lot of this is very disagreeable; and it will, in particular, be difficult to ensure that the change in respect of the nationalised industries is conducive to more efficient management. But I am convinced that if we do not go as far as is proposed in Annexes A and C we shall be in a poor tactical position, and we may well need to move to the position described in Annex D. We need to influence the initial drafting of the Bill. If it were to be tabled in a form which reflects only the PAC's proposals, we would, in moving amendments in Committee, appear to be trying to avoid full accountability to Parliament.

14. I, therefore, seek:

1. approval to negotiate with the backers of the Bill on the lines of Annexes A and C;
2. discretion to move, if necessary, to the position described at Annex D; and
3. agreement that, if a deal can be struck, drafting assistance to, and support for, the Bill may be offered.

GH

Treasury Chambers

14 December 1982

A POSSIBLE SETTLEMENTIAppointment and Status of C & AG and his Staff

- (a) Appointment by the Crown (on recommendation of a Commission consisting of the Prime Minister and the Speaker). Retirement at 60 (or ?65).
- (b) An independent office holder under the Crown i.e. not subject to direction either by Government or by Parliament (except by Act of Parliament). Paid direct from Consolidated Fund, as at present.
- (c) Task is to conduct :
- (i) certification audit (propriety of expenditure)
 - (ii) VFM audit (whether, accepting objectives, expenditure /collection of receipts is efficient)
 - (iii) Effectiveness audit (whether expenditure, although sound under (i) and (ii), has contributed effectively to policy aims)
- and report on them to House of Commons.
- Task is NOT
- (iv) to examine policies of Government (including future expenditure proposals e.g. Estimates).
- (d) Salary and conditions of service to be linked with those of the Clerk of the House, unless otherwise determined by the House on resolution proposed by the Speaker.
- (e) Staff of National Audit Office to be employed by C & AG on terms and conditions he thinks fit, having regard to the terms and conditions of civil servants and servants of the House. They will cease to be civil servants.
- (f) Budget of NAO to be controlled by House of Commons Commission (or a Public Accounts Commission). Estimates to be presented by the Speaker - with the consent of the Treasury to provide for a Cash Limit.

Nationalised Industries

1. We have hitherto resisted giving the C&AG and his staff access to the nationalised industries on a number of grounds. First, C&AG activity would tend to inhibit the industries from acting commercially and lead them to adopt defensive attitudes. Second, the Government legislated in the 1980 Competition Act to enable the MMC to conduct efficiency investigations and they provide a more effective instrument. Indeed we have over the past year taken steps to increase the number of MMC references and to improve the follow-up to their reports. Third and more generally, we were concerned that the line of responsibility for the industries should continue to run through Ministers to Parliament and that the scope of C&AG activity should not therefore exceed that for which Ministers could be held responsible. Otherwise the relations between Parliament, Ministers and Departments, and the industries could be seriously affected.

2. These arguments were, and remain valid. We have already offered a number of concessions in order broadly to maintain existing arrangements. We have encouraged the C&AG to use his access to departmental papers to examine how Departments exercise their responsibilities for nationalised industries. We have agreed to encourage the PAC to become involved in the follow-up to MMC reports. And we would have been prepared (as a final concession) to consult the PAC on the selection of references.

3. In considering what move we should now make in response to the St John Stevas Bill, we should keep our underlying objectives towards the industries firmly in view. We want a mechanism for conducting investigations into the industries particularly where competition is absent or weak. We want to avoid being drawn into day-to-day issues and thereby undermine the responsibilities of the management. We want the industries to act commercially; and we do not want to saddle them with two parallel systems of investigation - the C&AG and MMC - since this would be an excessive burden diverting the management from their main tasks.

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4. The key question is what moves we can make to satisfy the Bill's promoters which would at the same time offer the best chance of meeting our objectives. We have considered whether it would be possible to make a limited concession with the aim of preserving the present MMC system on broadly unchanged lines - for example by means of an understanding that the C&AG's powers would be used infrequently eg only when he had some prima facie reason to think there was misuse of public funds. Or possibly by associating the C&AG more closely with the industries' existing external auditors. But it seems quite clear that the C&AG and the PAC would not accept restrictions of this kind; indeed it is the C&AG's intention to have a permanent presence in all or most of the industries and to use their work as a means of deciding when to make a fuller enquiry. Options of this kind are not therefore worth pursuing. They are likely at the end of the day to mean parallel systems of enquiry by the C&AG and MMC. This would be a most undesirable outcome.

5. The only realistic option is to accept the principle of C&AG access to the industries and to seek to build an effective system on that basis. By making this important concession of principle we should be able to maximise the influence we can bring to bear on the shape of a new system and to see this reflected in the Bill. As a corollary, in order to avoid duplication, the use of the MMC for the purpose of efficiency investigations in the industries would cease (although it would continue to look into monopoly questions). We would either amend Section 11 of the 1980 Competition Act or simply restrict its use. The C&AG's remit would be limited to questions of efficiency and value for money, policy questions being reserved for departmental Select Committees. There should be no difficulty in agreeing this with the C&AG, although in practice the dividing line is not always clear cut.

6. The main risk under this option - and it is a real one - is of the C&AG's approach and methods inducing in the industries an uncommercial and defensive attitude. Our best hope of avoiding this is if we can encourage the C&AG to separate as far as possible - in

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terms of staff, expertise and methods of work - his task of examining trading bodies from his traditional work with Government Departments. Our aim must be to shift his approach into a more commercial direction. Ideally one would want to see the nationalised industry investigations carried out by a wholly separate command under the C&AG, using management consultants to provide cross-fertilisation with best commercial practice as well as staff directly employed by him. However it will be difficult to embody this in legislation; and although we would try to reach an understanding with the C&AG, he may be unwilling to go as far in this direction as we would like.

7. There are two other major questions which this option raises: influencing the C&AG's programme of enquiries; and following up the results.

8. On the first question, it is important that the Government continues to have a major influence on the programme of investigations. We will want to ensure that all industries are periodically scrutinised. And we will no doubt want particular industries examined from time to time in response to events. We should therefore try to ensure that there is systematic consultation between the C&AG and Government Departments before a programme is decided. We believe the C&AG would agree to this. We should try to get the point clearly embodied in the legislation.

9. On the second question (follow-up) it is less easy at this stage to see the way forward. A good deal will depend upon the nature of the reports the C&AG makes. No doubt the PAC will itself initially want to respond by questioning the industries and Departments on the report's findings. But where some major deficiency is revealed Ministers will wish to satisfy themselves that remedial action is taken by the industry. It is vital that the clear line of responsibility from the industries to their sponsor Minister is not blurred.

10. We shall need an early meeting between sponsor Ministers and the Nationalised Industries' Chairmen's Group. The industries have hitherto supported our attempts to hold off the C&AG: they will not

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welcome a change in our position. We shall need to convince them that there is now no choice but to make a move. Their main concern will be to avoid an increase in the number of external enquiries and bodies concerned in their affairs. My proposal, by substituting the C&AG for the MMC, should achieve this, although the question of the C&AG's proposed method of approach to the industries will also be important.

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A POSSIBLE SETTLEMENT

II

I Range of Audit

Full Audit:

- (a) All central Government accounts;
- (b) Other accounts as at present, as directed in legislation, or under a statutory instrument, subject to affirmative resolution, introduced by the Treasury.

Access to relevant papers:

- (c) Nationalised industries - with two provisos:
 - (i) A requirement in the legislation for the C&AG to consult the Government about his programme of investigations.
 - (ii) An understanding that these investigations would be carried out by specially trained staff in a self-contained branch of E&AD working to a defined remit - these points to be embodied in a formal memorandum of understanding.
- (d) Companies in which the Government has a majority shareholding.
- (e) Non-Departmental public bodies where the grant is less than 50 per cent of income.
- (f) British Technology Group (where E&AD at present audits only the NRDC side).

II Minor Items

- (a) Treasury to appoint auditor of C&AG (NAO) Appropriation Account.
- (b) Repeal s.3 of 1921 Act (leaving (b) above to cope).

III Not Included

- (a) Local Authorities (covered by Audit Commission)
- (b) NHS statutory audit (C&AG already has access). NHS audit under review anyway. If C&AG took it over a new internal audit would be required by DHSS).

Fall-back position in relation to companies:

(II(d) in Annex C)

(i) Categories where access could, in the last resort be permitted:

(a) Companies in which the Government holds more than 50 per cent of capital (loans plus equity) - this would have covered de Lorean.

(b) Companies which are in receipt of substantial selective assistance.

(ii) Categories where access should be resisted:

(c) Companies in which the Government holds less than 50 per cent of the capital - eg BP, British Aerospace, and companies in which BTG has a shareholding.

(d) Companies in receipt of automatic assistance (RDFs etc), or small amounts of selective assistance under standardised schemes.