



Prime Minister (2)

Local Gov

MUS 2 MARSHAM STREET  
LONDON SW1P 3EB  
22/7

My ref:

Your ref:

22 July 1982

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Dear Attorney General, att

I wrote to you on 26 February about my proposals to appoint private sector accountants as additional district auditors to audit the 1981/2 accounts of 14 local authorities. Three of the local authorities led by Derby challenged my power to do so in the High Court but my view was upheld. I have subsequently reappointed the same auditors to audit the 1982/3 accounts of the 14 authorities.

I am convinced that the private sector auditors can do much to help our general campaign for better value for money in local government and I wish to secure a substantial increase in private sector participation in local government audit. I, therefore, propose to appoint private sector auditors as additional district auditors to audit the accounts of about 100 further local authorities in England. This will bring private sector participation in local government audit up to 35-40%, and I shall be looking to the proposed Audit Commission to increase this to 50% in 1983/4.

Although the judgement in the Derby case was clearly in my favour my lawyers advise that there is a risk of legal challenge on this proposed new exercise, possible on the grounds that the appointments are unnecessary or unreasonable. I attach a note by my legal advisers which sets out the legal issues in more detail.

I would like to give each authority the opportunity to comment on the identity of the auditor I propose to allocate to it, as the Commission will be required to do under the Local Government Finance Act. But I did not do this on the previous occasion, on the grounds that it was not the practice to consult on the appointment of District Auditors, and will not do so now if there is any danger that this would in any way weaken my position in law. I should welcome your opinion on this point.

More generally, I would be grateful for your opinion on whether it is open to me to proceed in the way I have described. I need to announce this exercise before Parliament rises so I am afraid I must ask you for an answer by Monday.

I am copying this to Barney Heyhoe - whose approval I would require to these appointments - and to the Prime Minister and Geoffrey Howe for information.

yours sincerely  
Helen Ghosh

MICHAEL HESELTINE  
Rt Hon Sir Michael Havers QC MP (approved by the Secretary of State and signed in his absence)

## ADDITIONAL DISTRICT AUDITORS 1982/3 - LEGAL ISSUES

1. This note does not rehearse the arguments dealt with in previous correspondence between this Department and the Attorney General's Chambers, relevant extracts from which are attached, or which are covered in Forbes J's judgment in Derby City Council v Secretary of State, a transcript of which is also attached. It is however necessary to note, by way of background, that since that judgment was given there has been enacted the Local Government Finance Act 1982, Part III of which establishes (as from a day to be appointed) the Audit Commission for Local Authorities in England and Wales, which will take over most of the Secretary of State's functions in relation to local government audit. The Commission is likely to be in being in order to appoint auditors for the 1983/4 accounts; and take over the residue of audits of previous years' accounts on 1 April 1983. (A copy of the final Bill print is attached; the Act has not yet been printed, having received Royal Assent on 13 July).
2. Section 156 of the Local Government Act 1972 (c.70) enables the Secretary of State, with the consent of the Minister for the Civil Service, to "appoint such number of district auditors as he thinks necessary for the purpose of auditing accounts required to be audited in accordance with this part of this Act..."
3. The enabling power appears, as regards numbers, to confer a limited discretion. It does not merely state that the Secretary of State may appoint district auditors, or such number of district auditors as he sees fit or thinks desirable: it introduces the concept of necessity. There are two related arguments to which this could now give rise, neither of which was presented in the Derby case:-
  - (i) that the discretion to appoint district auditors is to be exercised having sole regard to the need for further district auditors and not to extraneous considerations such as the "value for money" expertise of the private sector (this was the point which appeared most to trouble Simon Brown in advance of the Derby case going to court, but in the result was not argued by Derby);
  - (ii) that, having regard to the previous history of the organisation of the district audit service and the past and present numbers of district auditors (currently 13), to appoint an additional number such as, in total, one hundred and twenty, is an unreasonable exercise of the power.

4. If there should be a challenge of this use of the power, it will have to be shown that only considerations which a court would regard as relevant were brought to bear in making the decision. Given the nature of the power, one would expect those considerations to be primarily of an organisational nature. It is in this context that anticipating the implementation of the 1982 Act becomes troublesome. A statutory power must be exercised for the purposes of the statute in which the power is conferred: in this case, broadly stated, the audit of accounts required to be audited in accordance with Part VIII of the 1972 Act. It is extremely doubtful whether in justifying greatly increased private sector involvement in Part VIII audits, any weight can legitimately be put on considerations of policy as to how the Audit Commission will go about discharging its functions (subject if necessary to the Secretary of State's connections) under the 1982 Act. In exercising functions under the 1972 Act the Secretary of State should, in the light of Padfield, have regard to the purposes of that Act and not anticipate its successor.

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To associate with copy  
2 MARSHAM STREET  
LONDON SW1P 3EE

letter from MH to Attorney  
General of 22/7, as  
requested

My ref:  
Your ref:

26 February 1981

*Handwritten scribbles*

SCRUTINY OF LOCAL AUTHORITY EXPENDITURE

You will know that, faced with the prospect of substantial increases in water charges, I have recently arranged for a team of private accountants to examine the basis on which the Water Authorities in England had prepared their budgets for 1981-82. This exercise was conducted very rapidly and at short notice, and with the co-operation of the Chairmen; and it has succeeded in pointing the way to significantly lower increases in charges than had been intended.

I want now to do something analogous in local government. I am convinced that in many local authorities there are areas of expenditure the need for which is never adequately questioned, and that very substantial savings could be produced by rigorous reviews of assumptions and accepted practice. I have already been able to arrange in a couple of cases for an independent short-term scrutiny by private accountants on the kind of informal and non-statutory basis on which the water industry exercise rested, and I intend to repeat this in further cases where the political relationships make it possible. But I need to be able to mount similar investigations on a statutory basis where the voluntary approach is not available; and I believe that my powers in relation to district audit under the Local Government Act 1972 enable me to do this. The District Audit service is of course fully stretched with routine work; and while I have the greatest respect for the District Auditors' expertise, I believe that in present circumstances there would be some benefit in introducing, alongside them, the distinct skills and experience of the private sector accountant. What I have in mind therefore is in a number of selected cases to appoint, under Section 156 of the 1972 Act, either as district auditor or as a person to assist him, members of private accountancy firms. The person appointed would of course have all the duties and powers of the District Auditor under sections 157-161 of the 1972 Act and might operate either as part of the normal audit cycle or, if the circumstances so required, on a direction from me under the extraordinary audit provisions of section 165.

This action would, of course, be a departure from the way in which the 1972 Act powers have been used in the past, and would without doubt generate opposition in local government. But the public concern about rate levels and our concern about both rates and public expenditure justify me in taking all reasonable steps to secure value for money and economy. I would be grateful for your

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opinion on whether it is open to me to proceed under these powers in the way that I have described. I attach a note by my Legal Adviser which sets out the legal issues in more detail.

I am copying this letter to Christopher Soames - whose approval I would require to these appointments under Section 156 - and to the Prime Minister and Geoffrey Howe for information.

*you saw*  
*MLL*

MICHAEL HESELTINE

## Legal Issues

1. There would not appear to be any legal objection to the Secretary of State (with the consent of the Minister of the Civil Service) supplementing the District Audit Service by making appointments under S.156 of the Local Government Act 1972 ( c. 70 ) of private sector accountants.

Section 156 replaces in an abbreviated form section 220 of the Local Government Act 1933 (c.51) where there was, in subsection (3), a specific reference to appointments of assistant district auditors and persons to assist district auditors.

2. It is thought prudent that such appointments should be on an individual basis rather than appointments of firms of private sector accountants to be district auditors or persons to assist district auditors. The reason for this is that the powers given to a district auditor by Sections 158 - 161 seem to pre-suppose that the district auditor will be an individual and not a firm.

3. It is, of course, open to a county or district council under S.154 of the 1972 Act to appoint an "approved" auditor as an alternative to having their accounts subject to district audit. The approved auditor must be a member, or a firm all the persons wherein are members, of one or more of the professional bodies listed in S.164(2) of the Act. This provision mirrors to some extent S.239 of the 1933 Act which empowered a borough council to resolve to adopt either district audit or a system of "professional audit". An approved auditor does not have such wide powers as a district auditor. Thus, under S.159(3), it is only a district auditor who may hear objections to a local authority's accounts made by a local government elector; under S.161, it is only the district auditor who may make applications to the court for a declaration that an item of accounts is contrary to law. An approved auditor, if he believes that an item of account is contrary to law, is required by S.162 to report the matter to the Secretary of State who may then direct an extraordinary audit under S.165. An extraordinary audit under the terms of that section has to be conducted by a district auditor. Under S.158(5) an approved auditor is

subject to a criminal penalty if he discloses (other than in the course of performing his functions) to any person any information obtained by him in carrying out a statutory audit. There is no corresponding provision in relation to district auditors.

4. The Chief Inspector of Audit has suggested that if the Secretary of State uses his power under S.156 to appoint, on a temporary basis, private sector accountants as district auditors or persons to assist district auditors, it might be argued on the basis of Padfield v Minister of Agriculture [1968] A. C. 997 that he was not carrying out the policy of the Act in that he was imposing on local authorities approved auditors in the guise of district auditors.

5. It is <sup>thought</sup> doubtful whether an argument on such lines would be likely to prevail unless it was pressed to the point of accusing the Secretary of State of mala fides.

6. In Asher v. Secretary of State for the Environment [1974] Ch.208, the Court of Appeal held that the Secretary of State's decision to hold an extraordinary audit could not be questioned in the courts "so long as he acts in good faith" (Lord Denning MR at p.228); "unless it was made in bad faith or was frivolous or vexatious" (Lawton L J at p.227). It is thought that the Secretary of State's discretion to appoint district auditors (or persons to assist them) under S.156 is in the same category. His power is to appoint "such number ..... as he thinks necessary". If he suddenly made a large number of temporary appointments from the private sector, it is thought that it might be argued that his decision was prompted by some indirect purpose, namely, that he wished, under the guise of district audit, to have something different. On this basis, the question of the legal risk attached to the exercise by the Secretary of State of his power under S.156 in the way proposed in paragraph 1 of this note would be one of degree rather than of kind.



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