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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister.
This is lamentable. And of course it links with the weaknesses we have seen recently in the Government's accountability capability and in relation to...
11/11

PRIME MINISTER

INTERNAL AUDIT

I am writing to give you advance warning of the publication, probably within the next week or two, of a highly critical report which the Comptroller and Auditor General has prepared for the PAC on the state of internal audit in Government. Treasury and CSD officials, and probably officials from some other Department, will be appearing before the PAC to answer questions about the report early in April.

2. The C & AG's diagnosis is that internal audit in Government has suffered from lack of professionalism, and lack of top management support. He believes that we are especially at risk in the area of computer audit. The Chief Inspector of Local Government External Audit not long ago made similar criticisms of internal audit in local government.

3. The C & AG does not identify specific cases of fraud or other types of leakage. This was not the purpose of his report. What he does suggest is that if there were systematic abuses we would be unlikely to know about them.

4. The report is disturbing. We and the CSD are well aware of the worrying problems and risks in this area. We accept the validity of the main criticisms - indeed the

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severest ones are based on the results of studies commissioned by CSD which confirmed the risks being run on computer systems. We must expect adverse publicity. The situation illustrates the need for the central departments to adopt a more positive role in relation to standards of financial management and control in Government departments.

5. Sir Douglas Wass has told me that he and Sir Ian Bancroft intend to send a joint letter to Permanent Secretaries to impress on them the urgency of remedial action, and suggesting a long-term programme of reform with emphasis on training and career management. It will emphasise the service that internal audit can provide for efficient management, and ask Permanent Secretaries to take a close personal interest in their department's internal audit arrangements, to review the objectives and staffing of the sections concerned, and to look particularly at the quality of the person in charge. I welcome this initiative, which, I believe, will set in motion a substantial and necessary improvement. It also has Sir Derek Rayner's full support.

6. I am sending a copy of this minute to the Lord President and to Sir Derek Rayner.

A handwritten signature in black ink, appearing to be 'G.H.' with a stylized flourish above it.

(G.H.)

" March 1981

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Gov. March



cc: Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Bailey
Mr. Littler
Mr. Burnger
Mr. Kemp
Mr. Kitcatt
Mr. Unwin
Mr. Perry
Mr. Ridley
Mr. C. Whitmore - No.10

MR. CAREY

AW
bin

THE ROLE OF THE COMPTROLLER AND AUDITOR GENERAL

The Chancellor discussed his minute to the Prime Minister of 24 February briefly with her on 3 March. I understand from Mr. Whitmore that the Prime Minister raised no objections to the arrangements suggested for interdepartmental study of the PAC's recommendations. The way is therefore open for the Treasury to organise the work, on the lines indicated in the Chancellor's minute.

JW

(A.J. WIGGINS)

6 March 1981

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ROLE OF THE COMPTROLLER AND AUDITOR GENERAL - PAC REPORT

Background

The report was published on Wednesday 4 March. It follows the Government's Green Paper of March 1980. At the moment, the C & AG's audit covers mainly Government departments, plus a number of statutory boards, but does not include the nationalised industries. The PAC argues the principle that the C & AG should be able to report on all bodies in receipt of public money, and recommends that while the normal financial audit of the nationalised industries, NEB, BNOC should continue, the C & AG should have access to the books in order to report to Parliament. He should also have access to the books of all companies and bodies in receipt of voted grants and loans. He should carry out the external audit of the NHS, and the staff which audit local authorities should come under him. His own department and the other staff would be reformed into a National Audit Office, borne on the House of Commons. Vote, and the C & AG will be appointed by the Crown on the recommendation of the House. The Green Paper argued that the C & AG should examine only where Ministers are accountable and thus he should not have access to the nationalised industries, etc. On local authorities, the Green Paper pointed to their local accountability.

Line to Take

The Government is most grateful to the Chairman of the PAC, and his Committee, for a most stimulating report. It has only just been published, and I cannot comment now on its wide ranging recommendations. The Government will give the report its fullest consideration, and make known its views in due course.

Supplementaries

Q1 Difference between PAC report and Green Paper

Answer: Yes there are important differences between the two.

It was a Green Paper. The PAC report raises important

and fundamental issues and we will look at the arguments very carefully.

Q2 When and how will the Government reply

Answer: There will be no unnecessary delay, but the report raises extensive and important questions. [If pressed - I would very much hope before the Summer Recess.] It would be normal for the Government to reply in a White Paper.

Q3 Legislation?

Answer: This will of course depend on the changes to be made. But if there is to be legislation, I would hope that it could be in the next Session.

Q4 Successor to Sir Douglas Henley (the present C & AG)

Answer: I am sure the PAC and the House will join in acknowledging the excellent service which Sir Douglas Henley has given. No decision has yet been made on his successor.



cc CSD

Paymer

J.L. 1005/1/11/11/11

H2

10 DOWNING STREET

From the Principal Private Secretary

20 March 1981

The Prime Minister was grateful for the Chancellor's minute of 11 March giving her advance warning of the Comptroller and Auditor General's report criticising the Government's arrangements for internal audit. The matter was of course discussed briefly in Cabinet last week.

The Prime Minister feels that Ministers have the right to expect their Permanent Secretaries to ensure that the arrangements for caring for taxpayers' money are beyond reproach. She was shocked to learn that the Treasury and CSD accept as valid the Comptroller and Auditor General's criticisms that internal audit lacks professionalism and top management support, with the result that systematic abuse would probably go undetected.

The Prime Minister is glad to hear that Sir Douglas Wass and Sir Ian Bancroft have an initiative in hand. She would like to be informed of the main elements in the programme of reform to which the Chancellor refers, preferably before officials appear before the PAC next month. She hopes that full consideration will be given to the use of a firm of professional accountants with the appropriate expertise in this specialised area. Plainly, the Government will be severely criticised if its programme of reform is not seen to be adequate.

The Prime Minister is also concerned lest the terms of the joint letter to Permanent Secretaries, as outlined in paragraph 5 of the Chancellor's minute, should be too tentative. She does not want any suggestion that action by Permanent Secretaries to tighten up their audit arrangements is optional.

I am sending copies of this letter to Jim Buckley (Civil Service Department) and Sir Derek Rayner.

CW

A.J. Wiggins, Esq.,
H.M. Treasury.

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H2

at Mr Osguid

MLL Mr Whitmore to see

19th

cc ✓ Mr Pattison
Mr Colman (CSD)
Mr J Taylor (HM Tsy)
Mr Littler

Go A Mech

AUDIT MACHINERY

1. Mr Joel Barnett, Chairman of the PAC, had lunch with Sir Derek Rayner yesterday.
2. The points discussed included the succession to the post of C&AG (dealt with ad rem, not ad hominem) and the impending report to the PAC on internal audit.
3. On the latter, Mr Barnett said, among other things, that IA in the Civil Service was lamentably out of date; it was barely credible that the Service felt so little shame about this; he intended to get explanations from the departments concerned, including the centre; and that he intended to keep calling departments back to make sure that they were making satisfactory progress.

CP

C PRIESTLEY
18 March 1981



CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8224

Mr. Barber 13/iii
Mr. Allen
Mr. Thomas
Mr. Callaghan

17 March 1981

*To see the 3 letters
of today's date and PA,
please.*

Sir Douglas Wass GCB

[Signature]
INTERNAL AUDIT

9
17.iii.81

1. I have seen Geoffrey Littler's letter of 16 March to Richard Wilding (CSD), with a draft submission to you and Ian Bancroft, suggesting that you should jointly write to your Permanent Secretary colleagues. Earlier, of course, I saw the Chancellor of the Exchequer's minute to the Prime Minister, alerting her to the possibility of adverse publicity in this area and saying that the joint initiative had my support.
2. As I am going abroad for two weeks shortly, I thought I should write to you directly with what are likely to be the last comments on this subject before you and Ian issue your letter.
3. As I have already told Geoffrey Littler, I think the new draft a vast improvement on earlier ones but it would be wrong for me to leave you under the misapprehension that I am wholly content with what is being proposed to you, despite its many real merits. I have also seen Ken Sharp's letter to Geoffrey Littler of 11 March and should let you know that I very much agree with his view that in order to give the initiative the momentum it deserves, and to keep it, something like a "task force", under a designated leader, is needed. I myself would put more emphasis on the "designated leader" than on the "task force".
4. In the draft letter which you are to consider, therefore, I should very much prefer you to name one of your officials in the Treasury as the lead person for this exercise, responsible to you for devising and implementing together with departments a plan for the reform of internal audit. At the moment, the draft speaks of two Deputy Secretaries, one in the Treasury and one in CSD, having a hand in these matters while the head of AFA will be available to give technical advice.

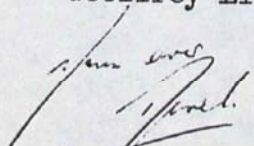
5. I have no doubt at all that the Treasury lead needs to be emphasised in order to give clarity and emphasis to the plan. I understand that the CSD has an involvement in such matters as recruitment, pay and training but I think that the right course is for them to advise the Treasury on such matters rather than act in tandem. Specifically, I think it is for the Treasury to approve appointments to headships and the composition of internal audit units. Otherwise I fear that the leadership given to departments is bound to be less clear than it should be and departments themselves somewhat confused about who is responsible for what.

6. On a rather different point, I think that departments would be greatly helped if your letter were more specific than it is at the moment on what the Treasury is going to do when. Paragraph 7 of the present draft speaks of work having begun on "producing fuller audit standards and guidelines, an audit manual, and wide range of specimen documentation. A new computer audit manual will be produced". Similarly, paragraph 13 speaks of the two central departments specifying "minimum training standards". My point is that there is plainly a touch of the chicken and the egg about all this. I would have thought that Permanent Secretaries would find it easier to respond to your requests if they were able to do so with guidance in their hands. It need not be fully worked up, of course but at the moment the draft does not have - to my mind, at least - the appearance of a firm plan to which departments are expected to conform. Perhaps the obvious example is in paragraph 9(ii) where you ask Permanent Secretaries to review the objectives of their internal audit units and the job description of their heads of IA without indicating when a "model" or some other paradigm is going to be available for comparison.

7. Finally, I think that many of the admirable things the draft says might be more effective if expressed more strongly. Two examples are your references to audit committees (paragraph 9(i)) and allocating to internal audit "a due share of really able staff" (paragraph 11).

8. In the former case, I would think it entirely reasonable of you and Ian to advise colleagues to establish an audit committee (saying how such bodies work) rather than saying that they might "wish to consider" this. In the latter case, I recall very well the emphasis with which you spoke over dinner on 2 December about the need to get good people into management-type jobs. Why not in this case say that you would expect departments to place such people as fast-stream Principals in such developing areas of audit as the quality of resource control and evaluation systems and computer audit?

9. I am copying this to Ian Bancroft, Ken Sharp, Geoffrey Littler and Richard Wilding.


Derek Rayner

17 March 1981

MR WHITMORE

INTERNAL AUDIT

1. The Chancellor's warning minute to the Prime Minister of 11 March about the C&AG's report was copied to David Wolfson, John Hoskyns and Bernard Ingham.
2. But the advice to the Prime Minister from Sir Derek Rayner's office of 12 March was not copied to us. This is one of a number of cases where we get a glimpse of an issue and then it disappears from view. Is it really so difficult for Private Office to be systematic about copying a string of papers on the same subject to us? I know that Private Secretaries are often very pressed for time, but other Private Offices manage to be consistent about circulation lists by delegating responsibility for checking them to Duty Clerks or their equivalents. Could we discuss whether this could be done here?
3. Turning to the substance of these papers, John Hoskyns also thought that the action outlined by the Chancellor in paragraph 5 of his minute seemed inadequate. He thought a firm of accountants with the right expertise (like Deloittes, Coopers etc) was needed. I suggest this point could be covered by inserting the following after the second sentence of paragraph 3 of the draft Private Secretary letter supplied by Mr Priestley:

X "She hopes that full consideration will be given to the use of a firm of professional accountants with the appropriate expertise in this ~~very~~ specialised area." X
4. I have suggested a couple of ways in which the letter could be toned down slightly (on a copy attached) *and shortened!*



ANDREW DUGUID

Minutes

Wiggins Esq
HM Treasury

*criticising the Government's
arrangements for welfare
audit*

INTERNAL AUDIT

1. The Prime Minister ^{was} ~~is~~ grateful for the Chancellor's minute of 11 March ~~and for~~ giving her advance warning of the Comptroller and Auditor General's ~~adverse~~ report ^{The matter was of some discussion briefly in Cabinet last week.}

2. The Prime Minister feels ~~very strongly~~ that Ministers have the right to expect their Permanent Secretaries to ~~ensure~~ ^{ensure} guarantee them that the arrangements for caring for ~~the~~ ^{the} ~~taxpayers'~~ ^{money} resources placed in their hands on behalf of the taxpayer are beyond reproach. She ^{was} ~~is~~ shocked to ^{learn} ~~hear~~ that the Treasury and CSD accept as valid the ^{CATG's} criticisms that internal audit lacks professionalism and top management support, with the result that systematic abuse would probably go undetected. ~~The Prime Minister finds it hard to regard this as anything other than a serious neglect of duty by senior officials over a period of years which is difficult to explain or excuse.~~

3. The Prime Minister is glad to hear that ^{an initiative} ~~is~~ in hand. She would like to be informed of the main elements in the programme of reform to which the Chancellor refers, preferably ⁱⁿ ~~in~~ advance of officials' appearing before the PAC next month. ^{Plan} ~~The~~ Government will be severely criticised if its programme ^{is} ~~is~~ not seen to be adequate.

*Sir Douglas Wain and Sir
John Boscawen have*

*Insert as
per
minute
x-x*

4. ~~Finally,~~ ^{step is also covered last} the Prime Minister ~~thinks that~~ the terms of the joint letter to Permanent Secretaries, as ^{outlined} ~~suggested~~ in

para^{graph} 5 of the Chancellor's minute, ^{shall} ~~appear~~ ^{may be too mild tentative.} - in the circum-
stances ^{too} ~~unsuitably~~ mild. She wishes ~~Permanent Secretaries~~
~~to be left under no illusion about their duties as stewards~~
on behalf of Ministers and ^{She does not want any suggestion} there to be no suggestion that
action by ^{Permanent Secretaries} ~~them~~ to tighten up their audit arrangements is
optional.

5. I am ^{sent copies of this} ~~copying~~ ^{John Roseley} this to Edward Chaplin (CSD) and
~~Clive Priestley (Sir Derek Rayner's Office)~~ ^{for} ~~Clive Priestley~~.

[Private Secretary]

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2.

Prime Minister.

Mr PATTISON

I think the letter should go. It is excellent.

You may be interested to see this, though I think yesterday's Cabinet discussion has made it unnecessary to send out a letter from here. AM 13/11

INTERNAL AUDIT

1. This minute offers some background information to help the Prime Minister in responding to the Chancellor of the Exchequer's minute of yesterday and suggests a draft private secretary reply.

Background

2. It is true that the Bancroft/Wass initiative "has Sir Derek Rayner's full support", but it remains for him to see and comment on a final draft of the joint letter to Permanent Secretaries. The present draft by no means has his wholehearted endorsement.

3. For the last three months Sir DR has been pushing, first CSD and now Treasury and CSD, to produce a plan for the reform of internal audit, rather than (as was CSD's first instinct) a too gentle, all too conscious of the problems plea to departments to do better.

4. The main things which struck Sir DR in this matter included these:

a. It is extraordinary that - despite all the emphasis the Service lays on accountability to and the Accounting Officer's special relationship with Parliament - the audit arrangements should be as bad as they have been described in the papers to which the Chancellor refers.

b. As only about 1 in 50 of the Government's internal auditors are professionally qualified (some units having no professionals at all), financial management in the Service is doubly unprofessional - its amateurs in finance branches are advised by amateur auditors.



c. The defectiveness of internal audit is attributable in part to confusion and indecisiveness at the centre. An early CSD draft observed:

"A contributory factor [in the failure to produce adequate standards of internal audit] has been the fact that the central expertise has been developed in the CSD, while the policy for internal audit standards rests with the Treasury. Partly for this reason, and partly because there has not so far been developed a clear doctrine about the extent to which the central departments should be responsible for satisfying themselves about the adequacy of departmental management systems (including audit), the centre has developed its concern with audit as an advisory part of its management services and not as a subject on which it should make standards mandatory and monitor their achievement."

d. The Service as a whole has so far failed to grasp the fact that high quality audit (of the kind provided to M&S by Deloitte, Haskins and Sell) goes very much further than the rather low level "propriety and regularity" audit on which it has concentrated, partly because professionalism is still looked at askance.

5. Sir DR regards the deficiencies of internal audit as an example not merely of the under-development of financial management in the Service but also of the neglect which can result from the "privacy" of Service management to which he referred in his minute to the Prime Minister of 30 January on management review.

campaign,

6. He therefore believes that a vigorous/under determined Treasury leadership, is needed to up-rate the quality of internal audit and of financial management generally. The Chief Secretary, who lunched with Sir DR on Monday, takes the same view in respect of financial management.



7. Reforming internal audit cannot be done quickly or easily. There are problems of attitudes, recruitment, training and - especially in relation to the new science of computer audit - technique. But there should be no shadow of doubt about either the need or the determination and imagination which will be needed to satisfy it.

Reply to the Chancellor

8. I attach a private secretary letter for consideration. It calls a spade a spade without overdoing it (I trust) and emphasises the importance of effective action.

SP

C PRIESTLEY
12 March 1981

Enc: Draft letter to Mr Wiggins

J A Wiggins Esq
HM Treasury


INTERNAL AUDIT

1. The Prime Minister is grateful for the Chancellor's minute of 11 March and for giving her advance warning of the Comptroller and Auditor General's adverse report.

2. The Prime Minister feels very strongly that Ministers have the right to expect their Permanent Secretaries to guarantee them that the arrangements for caring for the resources placed in their hands on behalf of the taxpayer are beyond reproach. She is shocked to hear that the Treasury and CSD accept as valid the criticisms that internal audit lacks professionalism and top management support, with the result that systematic abuse would probably go undetected. The Prime Minister finds it hard to regard this as anything other than a serious neglect of duty by senior officials over a period of years which is difficult to explain or excuse.

3. The Prime Minister is glad to hear that an initiative is in hand. She would like to be informed of the main elements in the programme of reform to which the Chancellor refers, preferably in advance of officials' appearing before the PAC next month. The Government will be severely criticised of its programme is not seen to be adequate.

4. Finally, the Prime Minister thinks that the terms of the joint letter to Permanent Secretaries, as suggested in



para. 5 of the Chancellor's minute, appear - in the circumstances - unsuitably mild. She wishes Permanent Secretaries to be left under no illusion about their duties as stewards on behalf of Ministers and there to be no suggestion that action by them to tighten up their audit arrangements is optional.

5. I am copying this to Edward Chaplin (CSD) and Clive Priestley (Sir Derek Rayner's Office).

[Private Secretary]