

Prime Minister

16/74



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The draft white paper rejects the PAC's recommendations for extending the C & AG's responsibilities, for transferring the ExAD into an Audit Office, and for bringing the new system under tighter

15 July 1981

The Rt. Hon. Francis Pym, MC MP
Chancellor of the Duchy of Lancaster

Dear Francis

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control. But it will promise a further Statement on building up the role of the name, and the establishment of an Audit Commission for Local Government.

WM
16/7

WHITE PAPER ON THE ROLE OF THE C & AG

.... We have said in the House that we expect to publish a White Paper on the Role of the C & AG before the Recess. I enclose a draft. Before circulating it to Cabinet colleagues I should bring to your attention certain aspects which will be of particular interest to you.

The White Paper responds to the PAC's report (First Special Report, Session 1980-81) published in March. That in turn commented on the Government's Green Paper (Cmd 7845) of March 1980.

The C & AG's present responsibilities are concerned mainly with the audit of central Government Departments, though they also embrace a number of non-departmental bodies. He is constitutionally independent of both Executive and Parliament.

The PAC want to extend his responsibilities to the whole of the public sector, including nationalised industries and local authorities, and beyond that to many bodies in the private sector. Their concern is with accountability to Parliament, and they argue that the C & AG should be empowered to follow public money wherever it goes.

They propose that the C & AG himself should become a servant of the House, and subject to direction by the PAC. His staff in the Exchequer and Audit Department (E & AD) would be increased in numbers, and would be transformed into a new National Audit Office which would also be brought under direct control of the House of Commons and managed by a new panel of backbenchers to be called the Public Accounts Commission.

/The PAC



The PAC proposals are radical. Similar proposals were put forward in the last Parliament by the Expenditure and Procedure Committees. John Garrett and Michael English have been exponents of these ideas in recent years.

The central thesis is plausible, but I do not believe the PAC's proposals would contribute to the efficiency of the public sector. In the important cases of nationalised industries and local authorities, they are right to say that there is a need for more public accountability. But I question whether the E & AD, even if strengthened and enlarged, is the right body for efficiency audit of the nationalised industries; we already have the MMC for that purpose and I would prefer to build on that. The White Paper promises a further statement on this in the near future: the idea is that this will be based on the outcome of the current CPRS review of the nationalised industries and of some further work that is being done by the Official Committee on Nationalised Industry Policy. Similarly, as regards local authorities, E Committee have accepted Michael Heseltine's alternative of building on the existing instruments of audit by establishing a new Audit Commission for local authorities in England and Wales.

The draft White Paper therefore rejects the PAC's main proposals for extending the range of the C & AG's activities. It sets out three basic reasons for doing so - the audit arrangements should reflect the degree of Ministerial responsibility; private sector auditors have a valuable contribution to make in the public sector, and their contribution should be increased; as a first priority, the C & AG should be able to carry out his present responsibilities as effectively as possible.

The PAC's proposals would lead to a substantial shift in the balance of power between Parliament and the Executive, and within that the Committee is seeking to extend itself at the expense of other Select Committees, and to fill the gap left by the demise of the SCNI. The PAC suggest that it would have to increase the number of its members, and one could foresee sub-committees being formed, for example on nationalised industries and local authorities, to meet the increased workload.

You will also be concerned about the proposal that the PAC should have power to give directions to the C & AG. The PAC recognised that this raised the question whether the E & AD should be available to assist other Select Committees, and concluded that the PAC alone should have the power of direction, while leaving open the possibility that it would use that power on behalf of other Committees. This has implications for the staffing of E & AD and relations between



E & AD Departments. From the point of view of the Select Committee system, it raises in another form the relations between the PAC and other Select Committees, and perhaps more important the implications of giving other Select Committees access to the substantial and experienced staff of the E & AD.

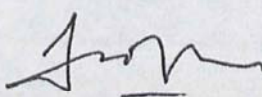
The draft White Paper rejects this proposal, and the case for bringing the C & AG, and his staff in E & AD, formally under Parliament. The previous PAC, under Edward Du Cann, took the opposite line to their successors. I believe the previous Committee were right. As well as the reasons given in the draft White Paper, I am not, as you know, impressed by the way in which Parliament manages the staff already on its pay-roll, so that I should be reluctant to see a growth in that direction. The C & AG has written to me arguing against a power of direction. If it was necessary in debate I think that we could consider some concession in respect of the staff in E & AD, although change would, in any case, require legislation.

The Green Paper argued that it was desirable to update the Exchequer and Audit Acts, but said that if the role of the C & AG was not to be fundamentally changed, the need for new legislation was not pressing. The PAC's proposals would, of course, require wholesale revision to the legislation. The White Paper says that the Government leaves open the possibility of legislation during this Parliament, but that there should first be a substantial consensus about its content; and other developments in Parliamentary procedure will need to be taken into account.

We shall have to offer a debate on the draft White Paper in Government time, presumably in the autumn. While the White Paper has been drafted to avoid confrontation with the PAC as far as possible, and to emphasise the areas of agreement, it will be clear that it substantially rejects the views of the PAC. Those views may attract support. Other Committees have previously put forward similar proposals. However, I believe that the PAC's proposals are not the right way to improve efficiency in the public sector, and we shall have sound alternatives to offer for the nationalised industries and local authorities.

I should be grateful to know that you are content with the line the draft White Paper takes on these matters.

I am copying this letter to the Prime Minister, Christopher Soames, Michael Heseltine and Sir Robert Armstrong.

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DRAFTWHITE PAPER ON THE ROLE OF THE C & AG

1. In their First Special Report⁽¹⁾ for the 1980-81 Session, the Committee of Public Accounts (PAC) make a number of recommendations for extending the scope of the work of the Comptroller and Auditor General (C & AG), and for changing his status. The PAC took as their starting point the Government Green Paper (Cmnd 7845) published a year earlier, and recommendations on the same subject by the Expenditure, Procedure and Public Accounts Committees of the last Parliament.⁽²⁾
2. This White Paper sets out the conclusions which the Government have reached after careful consideration of the Committee's Report and the substantial body of evidence submitted to the PAC in connection with their enquiry.

I THE GENERAL ISSUES

3. The Government's general approach to the Committee's Report is based on three guiding principles which the Government believe must be taken into account in determining the role of the C & AG. The first is the principle of Ministerial responsibility to Parliament, set out in the Green Paper. This constitutional convention does not fit all cases neatly but remains the only effective means by which Parliament can hold to account those to whom money is voted.
4. The second principle is the need for high standards of financial stewardship and prudence in handling public money. The Government agree with the many comments on the Green Paper in this sense, and recognise the contribution which can be made to this by audit in all its forms. But the Government do not share the Committee's implicit view that, apart from internal audit, this contribution should be made for the whole of the public sector only by the C & AG. It is beyond question that the private accountancy profession has the competence to do such work, bringing to it experience of auditing private firms, and this is of great value to the audit of many public sector bodies.
5. The third principle derives from the evidence that standards of audit, both external and internal, of Government Departments require improvement. The Government wish to

(1) 'The Role of the Comptroller and Auditor General' (HC 115)

(2) Eleventh Report from the Expenditure Committee, Session 1976-77, (HC 535)
First Report from the Select Committee on Procedure, Session 1977-78, (HC 588)
Second Special Report from the Committee of Public Accounts, Session 1978-79,
(HC 330)

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work with the PAC and the C & AG to achieve this. The scope for achieving this improvement will be reduced if the C & AG's work is extended into large new areas of administration with which his Department is at present unfamiliar. The first priority, in the Government's view, is to ensure that the C & AG is able to carry out his present substantial responsibilities as effectively as possible.

New Legislation

6. It remains the Government's view that it would be useful to introduce legislation to provide an up to date prescription of the C & AG's functions. But this is not a pressing need. Experience of the past two years suggests that the existing legislation need not in fact inhibit further desirable changes in the work of the C & AG and the PAC.

7. The Government will keep under review the possibility of legislation within the lifetime of this Parliament. They believe there should be a substantial consensus within the House about its content. Debate on the White Paper may provide an indication how far there is wide agreement in the House on particular legislative changes. Other prospective developments in Parliamentary procedure and Government Accounting may need to be taken into account in framing any new legislation.

II THE NATURE OF THE C & AG's AUDIT

8. The Government agree with most of the Committee's comments and conclusions in Chapter 2 of the Report about the nature of the C & AG's audit. They welcome the Committee's endorsement of the systems-based approach for audit reporting in the field of value for money (VFM) examination. The Government think the Committee are right to say that VFM investigations by the C & AG should be audit-based. The Committee's discussion of effectiveness audit shows that there is agreement on the important point that the C & AG should refrain from raising the merits of policy objectives.

III THE RANGE OF THE C & AG's AUDIT

9. The recommendation that "new legislation should establish the principle that the C & AG should either audit, or have access to, the books of all bodies in receipt of money voted by Parliament"⁽³⁾ is applied by the PAC to nationalised industries, other public corporations, local authorities, and many commercial bodies in the private sector. The Government agree that an essential part of the role of the C & AG is to ensure accountability to Parliament for public money, but as mentioned above they wish to see

(3) HC 115, para. 8.8

more, not less, involvement of the private sector in the audit of public spending and to avoid over-loading the C & AG. They believe that in defining the range of activities of the C & AG account should be taken of the principle and extent of Ministerial responsibility to Parliament. Audit arrangements should reflect the constitutional relationships between central government and the various bodies in receipt of public funds. Accountability to Parliament cannot be created simply by changing the auditing arrangements.

(a) The Nationalised Industries and Other Public Corporations

10. The Government fully share the PAC's concern about the need to promote the efficiency of the nationalised sector. Not only do the nationalised industries represent a significant proportion of the economy, but to a considerable extent they are insulated from competitive pressures. For this reason Parliament recently legislated (in the Competition Act 1980) to allow the Monopolies & Mergers Commission (MMC) to undertake efficiency investigations into the nationalised industries. The MMC has made a good start. Their investigations, of which 4 have been completed in the last 12 Months, have identified a number of areas of weakness in the industries' operations.

11. The Government are not convinced that it would be fruitful to replace this framework so soon after its inception. The better course in their view is more vigorous use of the instruments that already exist. With this in view the Government are currently considering how the role of the MMC in the field of efficiency audit can be strengthened and supplemented. A further statement will be made in the near future.

12. As the auditor of the accounts of the sponsor departments, the C & AG has access to reports submitted by the MMC and by the industries' auditors to the responsible Ministers. He can report on any inadequacies in the monitoring and control arrangements, and in the scope or validity of the information available to those Departments. The Government would welcome PAC examination, on the basis of C & AG reports, of departments' exercise of their responsibilities in this area. But they do not think the case has been made out for the further step, at this stage of development of arrangements for efficiency audit of the industries, of involving the C & AG directly in the industries' affairs. They note that to extend his role in the way envisaged by the PAC would result in a substantial increase in the work of the C & AG and his Department in a novel area.

13. Similarly, the Government do not favour systematic extension of the C & AG's role to the water authorities or to other public corporations. But they agree with the PAC that the fact that a body's activity is in whole or part commercial in character is not in itself an obstacle to giving the C & AG any form of audit responsibility for the body's accounts.

(b) The National Enterprise Board (NEB)

14. Under its present guidelines, the NEB is required to work in partnership with private sector capital wherever possible. Its operations depend for their effectiveness on co-operation and free exchange of commercially sensitive information with private sector companies and investors. The prospects of such co-operation would be impaired if the C & AG were to be given access to the books and records of the NEB.

15. The Government have announced recently their intention of bringing the NEB and the National Research Development Corporation closer together. If this leads to their eventual amalgamation, the question of accountability of any new body to Parliament will be considered when legislation is introduced.

(c) Local Authorities

16. The Government agree with the Committee that some reform is needed of local authority audit arrangements, but do not believe that the right solution is to put the District Audit Service under the control of the C & AG. For those functions relating to local authority activities for which Parliament has given them responsibility, Ministers are already fully accountable to Parliament. The Government do not consider that the C & AG needs for that purpose access to more information than is available to the Departments under audit.

17. The Government attach particular importance to the value for money content of local authority audit, and agree with the PAC about the desirability of further developing co-operation on technical matters between the District Audit Service and E & AD. The Government see an important role in local authority audit for auditors with private sector experience. They believe that the interests of all parties concerned, including local electorates, will best be served by the establishment of an Audit Commission for local authorities in England and Wales [as announced by the Secretary of State for the Environment on]. The C & AG can be associated with the Audit Commission as he is now with the work of the Advisory Committee on Local Government Audit. The Government propose that present arrangements for the Commission for Local Authority Accounts in Scotland should continue but will wish to consider in due course whether experience of the new arrangements in England and Wales suggests that the arrangements in Scotland should be reviewed.

(d) Non-departmental Public Bodies (NDPBs)

18. Most NDPBs are advisory or judicial and do not spend money on their own account; in almost all cases their expenses are borne on the Votes of their sponsoring Departments and are therefore audited by the C & AG. It is only a minority of bodies which spend money on

their own account; they generally exercise executive functions and are listed as "executive bodies" in 'Non-Departmental Public Bodies: Facts and Figures 1980' (HMSO, 1981). Paragraphs 19 to 21 apply only to these bodies, apart from the water authorities and the NEB which are considered separately in paragraphs 13-15.

19. Irrespective of their functions, size and the degree of Ministerial control over them, the Government are determined that all these bodies should achieve high standards of effectiveness, efficiency and economy. They recognise and welcome the contribution which the C & AG can make to achieving these standards and to proper accountability to Parliament.

20. The Government agree generally with the policy suggested by the PAC concerning NDPBs,⁽⁴⁾ but doubt the need to give the C & AG formal audit responsibility for all bodies mainly or wholly financed by Government. In many cases the requirements of accountability to Parliament can be met by ensuring that the C & AG has access to the books of the bodies concerned without requiring him to undertake full certification audit. In this way, the useful links which have been established between many bodies and their private sector auditors can be retained.

21. Most NDPBs are already subject to C & AG audit or access. Ministers will, however, be conducting periodic reviews of the bodies they sponsor and will consider in the course of these reviews whether audit arrangements are satisfactory.

(e) Private Sector Recipients of Government Grants and Loans

22. The Government do not agree with the PAC's proposal that the C & AG should have access, "where he considers it necessary",⁽⁵⁾ to the books and records of private sector companies in receipt of Government grants or loans. Should the C & AG and his staff become involved in this way, such companies would be understandably concerned about disclosure of details of their commercial affairs.

23. The C & AG has access to departmental files in the course of his audit and can consider papers relating to companies receiving public funds. He is therefore already able to examine reports made by private sector accountants whom Departments may employ in assessing requests for support from private sector companies. Since Departments monitor the use companies make of loans and grants, he can also report on this aspect of departments' activities.

(4) HC 115, Ch.3 and paras. 8.10(a) and (b)

(5) Hc 115, para. 8.10^d(~~e~~)

(f) National Health Service

24. As the PAC recognised, the "statutory" auditors of the NHS are an integral part of the oversight of the NHS by the Accounting Officers of the Health Departments. If the "statutory" audit were transferred to the C & AG as the PAC recommend, the Health Departments would have to make other arrangements for the internal audit of the NHS, thus in large measure duplicating the C & AG's work. The C & AG already has access to NHS papers at all locations enabling him to pursue his enquiries where he wishes. The Government agree that there should be the fullest co-operation between the staffs of the E & AD and the "Statutory" audit, but are not persuaded of the case for more fundamental changes.

IV THE STATUS OF THE C & AG AND OF HIS STAFF

25. The PAC proposed that the C & AG should become an Officer of the House appointed by the Queen by letters patent on the recommendation of the House of Commons; that the PAC should be able to give the C & AG directions to investigate particular programmes or projects; that the existing staff of E & AD and the DAS should become servants of the House and transformed into a new National Audit Office; and that a Public Accounts Commission of the House should be established with responsibility, among other things for determining the number of staff in the National Audit Office and their pay and conditions of service.

26. The Government are not convinced by the PAC's proposals as to the status of the C & AG or as to the question of powers to give him directions. There are as good reasons in the public sector as in the private sector for regarding independence as one of the essential attributes of an auditor. The Government believe that within the framework of specific legislative provision the C & AG should continue to be totally independent of any form of external influence or direction in the performance of his duties. The C & AG himself expressed this view in evidence to the Committee. The same view was taken by the PAC of the last Parliament.⁽⁶⁾ The PAC already have a working relationship with the C & AG which has proved effective over many years and to which both the Government and the Committee attach considerable importance.

27. The established method of appointment of the C & AG is by letters patent by the Queen on the advice of the Prime Minister. The Government are not persuaded of the case for changing it, but reiterate their view that when a new appointment is in contemplation, it will be appropriate for the Government to consult the Chairman of the PAC. This was done

(6) Second special Report from the Committee of Public Accounts, Session 1978-79, (HC 330), para. 15.

in regard to the new appointment recently announced.

28. In the Green Paper, the Government said that they would be ready to consider some form of control by the House of Commons Commission as an alternative to the oversight of the C & AG's budget and the staffing costs of E & AD currently exercised by CSD. That remains their position, but the Government consider that the balance of advantage lies in retaining the present arrangements. As the Committee acknowledge, the E & AD have been exempted from the recent cuts in Civil Service numbers; indeed, the C & AG has reached agreement with CSD on a substantial programme to increase staff numbers over the next five years to enable the Department adequately to fulfil its existing responsibilities. The Committee acknowledges that the present administrative arrangements work.

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PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster
and
Paymaster General

21 July 1981

Dear Geoffrey,

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2/7

WHITE PAPER ON THE ROLE OF THE C & A G

You wrote to me on 15 July enclosing a draft of a White Paper in response to the First Special Report (Session 1980-81) of the Committee of Public Accounts.

I am in general agreement with the line taken in the draft White Paper.

I have only two comments:-

- (i) In paragraph 7, whilst I agree there may well in due course need to be a debate on these proposals, I would not have thought it necessary at this stage to go beyond a general undertaking to keep under review the possibility of legislation. This might perhaps be incorporated at the end of para 6. The remainder of paragraph 7 might, I suggest, be omitted.
- (ii) In the last sentence of the second paragraph on page 3 of your letter you appear to suggest that we might at a later stage consider a concession to bring the staff in E & A D formally under Parliament. I do not believe this would be welcome to the House of Commons Commission, for whom it would be a major extension of their staffing responsibilities. Nor do I see another House Commission coping with the job. It might also prove contentious with the staff concerned. I would hope, therefore, that our position would remain as stated at paragraph 28 of the draft White Paper.

I am copying this to the recipients of your letter.

Francis Pym
Francis Pym

FRANCIS PYM

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

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MINISTER FOR LOCAL GOVERNMENT AND ENVIRONMENTAL SERVICES

My Ref: H/PSO/16343/81

22 July 1981

Dear Geoffrey

WM 23/7

WHITE PAPER ON THE ROLE OF THE C & A G

Thank you for sending Michael Heseltine a copy of your letter of 15 July to Francis Pym. Subject to incorporating a reference which my officials have given to yours about our proposals for the future audit of the water authorities, I confirm that the draft deals satisfactorily with our particular interests, notably the proposed Audit Commission.

Like you I realise that the draft White Paper will not be well received by some quarters in Parliament. But I see no alternative to the main line of argument so far as nationalised industries and local authorities are concerned.

I am copying this letter to the Prime Minister, Christopher Soames, Francis Pym and Sir Robert Armstrong.

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TOM KING

The Rt Hon Sir Geoffrey Howe QC MP