

1 Mr Pattison

CONFIDENTIAL

2 Prime Minister

1

Mr Heseltine will make his statement on the Audit Commission the same day.



You have already seen the Chancellor's identical letter to Mr Pym seeking his approval for this White Paper.

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

Content for it to be published on Tuesday 28 July?

PRIME MINISTER

WHITE PAPER ON THE ROLE OF THE C & AG

Yes Mr WFR 21/7

.....
The purpose of this minute is to invite your agreement, and that of other Cabinet colleagues, to the publication on 28 July of the attached draft White Paper on the Role of the Comptroller and Auditor General (C & AG). The draft has been the subject of extensive consultation between Departments.

2. The White Paper replies to the PAC's Report (First Special Report, Session 1980-81) published in March on the Role of the C & AG. The PAC's central recommendation was that the C & AG should be able to pursue public funds wherever they go. This would affect, inter alia, the nationalised industries, local authorities and numerous other public and private sector bodies in receipt of Government grants and loans. They further propose that he should become an Officer of the House and subject to the direction of the PAC. His staff in the Exchequer and Audit Department (E & AD) would be expanded and turned into a new National Audit Office. This would be controlled by a Public Accounts Commission consisting of members of the House of Commons.

3. These are radical proposals. They are essentially the same as recommendations in the last Parliament by the Expenditure and Procedure Committees. Michael English and John Garrett have long advocated these changes.

4. While I find it difficult to disagree with the PAC's diagnosis of a need for improvement in our system of public aid and accountability, I find it equally difficult to agree with their remedy. On the important question of local authority audit, we have already accepted Michael Heseltine's recommendation for the



establishment of an Audit Commission for local authorities in England and Wales. As to arrangements for the efficiency audit of nationalised industries, I believe that the right course is to build on the useful work already done by the MMC. The further statement on this promised by the White Paper will be based in part on the outcome of the current CPRS review of the nationalised industries.

5. The draft White Paper therefore rejects the PAC's main proposals for expanding the C & AG's responsibilities. In it, three basic principles in support of this position are set out: audit arrangements should reflect the degree of Ministerial responsibility; private sector auditors have a valuable contribution to make to the work of many public sector bodies; and the first priority is given to ensuring that the C & AG can carry out as effectively as possible his present substantial responsibilities.

6. On the status of the C & AG, the White Paper sides with the previous PAC (under Edward Du Cann) in favour of leaving the C & AG completely independent. On control of the E & AD, the White Paper though rejecting the PAC proposal, takes a somewhat more open line.

7. On the question of more general legislation, the Green Paper acknowledged the case for a more up to date prescription of the C & AG's functions. But it noted that the need was not pressing since the E & AD Acts posed no insuperable barriers to the development of the C & AG's work. The White Paper specifically leaves open the possibility of legislation during this Parliament, but restates the view expressed in the Green Paper that there should be a consensus about its content.



8. Though the White Paper has been drafted in as conciliatory way as possible, emphasising all areas of possible agreement between the Committee and the Government, the PAC will not welcome this reply to a report which occupied a great deal of time and effort on their part. We are likely to be pressed to offer a debate in Government time in the autumn. We shall not be without counter-arguments, and we can point to positive alternative policies for the local authorities and nationalised industries.

9. We have said that we hope to publish the reply to the PAC before the recess, and I see some advantage in getting it out as soon as we can. I should be glad to know if you would be content for the White Paper to be published on 28 July.

10. As you know, I think there would be advantage on all sides in synchronising publication of this White Paper with Michael Heseltine's announcement of the Audit Commission. If that were to take place in isolation and ahead of our response to the PAC report, it could provoke an even less enthusiastic reaction from the PAC than they are likely to give to the course which I propose. My Private Secretary has written separately about this, and I understand Michael Heseltine has now agreed to postpone his announcement to make this possible.

11. In order to meet this timetable, I should be grateful if colleagues could let me have any comments by close of play on Friday, 24 July.

12. I am copying this to all members of the Cabinet, to Norman Fowler and to Sir Robert Armstrong.

Robert Jenkins

for (G.H.)

21 July 1981

(Approved by the Chancellor of the Exchequer and signed in his absence).

DRAFT

WHITE 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 his staff in the Exchequer & Audit Department (E & AD), and for changing their 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 predominantly by the C & AG. It is beyond question that the private sector accountancy profession has the competence to do such work, bringing to it a wide variety of commercial and industrial experience, and this is of great value to the audit of many public sector bodies.

(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)

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 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.

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, non-departmental public bodies, and many commercial bodies

(3) HC 115, para. 8.8

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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 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 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. As regards the Water Authorities in

England and Wales, the Government propose that they should in future be audited by private sector auditors appointed by the Secretaries of State and not, as at present, by District or approved auditors. 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 for 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 prepared.

(c) Local Authorities

16. The Government agree with the Committee that some reform is needed of the arrangements for local authority audit, 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} has been announced separately [today] by the Secretary of State for the Environment. The C & AG can be associated with the work of the Audit Commission as he is now with that 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 below 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 these bodies, the Government are determined that all of them 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 approach 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 are adequately met by existing arrangements under which the C & AG has access to the books of the bodies concerned without requiring him to undertake full certification audit. These arrangements have permitted the establishment of useful links between the bodies and their private sector auditors.

21. Most NDPBs are already subject to C & AG audit or access. In some cases, Parliament has specifically prescribed commercial audit by legislation. 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.

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

(5) HC 115, para. 8.10(d)

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.

(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 to enable this oversight to be exercised, 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 District Audit Service 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 for, among other things, 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

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

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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 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 the Civil Service Department (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 the 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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DS



10 DOWNING STREET

From the Private Secretary

23 July 1981

Dear Peter

WHITE PAPER ON THE ROLE OF THE C & AG

The Prime Minister was grateful for the Chancellor's minute of 21 July. She is content for this White Paper to be published on 28 July, and has no comments on the Chancellor's draft.

I am sending copies of this letter to the Private Secretaries to members of the Cabinet, to Anthony Mayer (Department of Transport) and to David Wright (Cabinet Office).

yours
Willie Rickett

Peter Jenkins, Esq.,
H.M. Treasury.

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From: THE PRIVATE SECRETARY

WR
27/7
Gust Mack



HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

24 July 1981

Dear Sir

WHITE PAPER ON THE ROLE OF THE C & AG

This is just to let you know that the Home Secretary has seen a copy of the Chancellor's minute of 21 July and is content with his proposal to publish the White Paper as revised on 28 July.

I am copying this letter to the Private Secretaries to all members of the Cabinet and to David Wright (Cabinet Office).

Yours sincerely
C J Walters

(C J WALTERS)

P S Jenkins Esq



From the Secretary of State

Govt Mach

Wm
27/7

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The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

27 July 1981

Dear Geoffrey,

WHITE PAPER ON THE ROLE OF THE C AND AG

Thank you for giving me an opportunity to comment upon the draft White Paper enclosed with your minute of 21 July to the Prime Minister.

The Paper's somewhat oblique approach to certain sensitive matters no doubt reflects the need, to which you refer, to seem conciliatory at the same time as rejecting much of what the PAC has asked for. I am content that it should be published on the 28th as it stands. However, I should make it clear that the NDPBs for which I am responsible cannot be broken down into neat categories and that I shall rely heavily upon the reference to ministerial review in paragraph 21 should I wish at any time to vary (in either direction) audit arrangements which are largely a matter of historical accident or practical convenience.

I am copying this letter to the recipients of yours.

Yours
John Biffen

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JOHN BIFFEN



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Secretary of State for Industry

28 July 1981

Rt Hon Sir Geoffrey Howe QC MP
 Chancellor of the Exchequer
 HM Treasury
 Parliament Street
 London SW1

*Arrive Chancellor's response
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 3/7*

Ken Giffney.

WHITE PAPER ON THE ROLE OF THE C & AG

Thank you for sending me a copy of your minute of 21 July to the Prime Minister covering the text of a White Paper setting out the Government's response to the PAC's proposals on the Role of the C & AG. I recognise that this has been a difficult drafting exercise and that it is necessary to appear conciliatory while rejecting almost everything of real significance asked for by the Committee. I agree to the publication of this text on Tuesday.

2 It may be as well to set out briefly the line which I think that the Government should pursue in the debate which you foresee for the Autumn.

3 On the NEB (paras 14 and 15) I should wish no change in the audit arrangements which at present exclude the C & AG from both audit and more general scrutiny. I shall also oppose C & AG access to any new body arising from the amalgamation of the NEB and the NRDC.

4 Paragraphs 22 and 23 deal summarily with the radical notion that the C & AG should be able to pursue Government grants or loans wherever they go in the private sector. I welcome the statement that the Government "do not agree with the PAC's proposal". I should make it clear that I regard this as also rejecting any idea of C & AG access to the books of British Leyland and Rolls Royce which are not specifically mentioned in this context.

5 I am copying this letter to recipients of your minute.

Emma

Ken