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The Public Accounts
Commission

Corporate Governance of the National Audit Office: Response to John Tiner's Review

Fifteenth Report

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Corporate Governance of the National Audit Office: Response to John Tiner's Review

Introduction

1. On 11 July 2007 we decided to review the corporate governance arrangements of the National Audit Office (NAO) to ensure that these conformed to best practice. In November we commissioned John Tiner to conduct the review, with terms of reference which focused on the role of the Comptroller and Auditor General (C&AG) and his relationship with the NAO. Following the submission of the review to us by John Tiner, we discussed it with him and with Tim Burr, C&AG, on 5 February. We published the review, without comment, on 6 February as our 14th report.¹ The purpose of the current report is to give our response to the review.

2. We are grateful to John Tiner for his thorough and helpful analysis of the current governance arrangements of the NAO and for his proposals. We believe his review makes a convincing case for strengthening the corporate governance of the NAO, and we warmly welcome it.

The role of the C&AG

3. Our starting point is the fundamental importance of preserving the independence of the C&AG in deciding what audits to carry out and in making audit judgments, and above all in preserving his or her independence from the executive. The uniqueness of the C&AG's role is that he or she not only runs a large organisation but is also responsible for the audit judgments made by that organisation. The C&AG's independence is an absolute requirement for effective audit and is the cornerstone of integrity in public finance in the UK. That independence can easily be taken for granted, but would very soon be missed if it were compromised, and therefore great care is needed when altering in any way the corporate governance of the NAO.

4. The C&AG's independence from the executive is symbolised by his or her status as an Officer of the House of Commons,² which also makes clear that the C&AG is a servant of the House. We attach great importance to that status as an Officer of the House. In fact the C&AG's independence is preserved even from the House by the fact that he or she has, by statute, "complete discretion in the discharge of his functions".

5. The need for the C&AG to be able to make independent judgments is recognised in John Tiner's review. We endorse the three objectives set by John Tiner for the governance of the NAO, which are as follows:

1 Public Accounts Commission, Fourteenth Report, *Review of the National Audit Office's Corporate Governance* (February 2008), HC 328 (2007-08). The terms of reference are at para 12 of that report.

2 National Audit Act 1983, s.1 (2).

- “The C&AG must have the authority to form completely independent judgements about the audits and value for money and other studies conducted by the NAO and the presentation of these to Parliament.”
- “The NAO must maintain systems of governance and internal controls consistent with best practice, applied in ways which do not fetter its independence from Government, and to report publicly on these systems in its Annual Report.”
- “The NAO must conduct its work according to relevant auditing and professional standards and prevailing best practice.”

6. At present the NAO’s governance arrangements give absolute priority to the first objective at the expense of the second, so that the checks and balances which should ensure good governance are absent. The central problem in strengthening the NAO’s corporate governance is how to achieve the second objective without compromising the first. Most of our response to the review focuses on this issue.

Specific proposals

The proposed NAO Board and Chairman

7. We agree with John Tiner that there is a need for an NAO Board which includes members and a Chairman with sufficient authority and independence from the C&AG to challenge him or her when necessary. There must be enough of a role for the Chairman to make it worthwhile for a person of sufficient expertise, experience and authority to take on that responsibility.

8. There is general agreement that it would be unacceptable if the Chairman were able to constrain the C&AG’s audit decisions (including decisions on what audits to conduct) or to act as an alternative figurehead for the NAO, given that the Chairman would not be responsible for what the NAO actually produces, which is audit judgments. With this in mind, we agree to the proposal for a Chairman on the basis that he or she would have only an internal role, and would speak in public only about governance matters, and in particular would not comment on the audit reports or the audit programme of the C&AG. Given that the role would be largely internal, the Chairman’s interventions in public would be rare. We would prefer the Chairman to be Chairman of the NAO Board rather than of the NAO, if legally possible. The C&AG would act as Chief Executive of the NAO, would lead the NAO executive, would manage the NAO’s resources (as discussed below)³ and would be the public face of the NAO.

9. Crucially, the Chairman would have access to the Commission. The Chairman would appoint the Chairman of the Audit Committee, and might well appoint himself or herself to that position. He or she would also appoint the Chairman of the Remuneration Committee, and might also chair that. One day a week would probably be an appropriate level of commitment. Remuneration would be set with reference to similar posts in other organisations. We believe that the role would be of sufficient importance to attract candidates of high calibre.

3 Paras 13-14.

10. The Chairman should be appointed in the same way as the C&AG ☒ by agreement between the Prime Minister and the Chairman of the Committee of Public Accounts ☒ and would be a Crown appointment. In this way there would be political balance in the appointment process, as there is for the C&AG. We are content with the term suggested by John Tiner: a three-year term, subject to renewal for one further three-year term.

11. Our views on the composition and appointment of the Board are as follows:

- The Board should have seven members.
- There should be a narrow majority of non-executives, which means three executive members (including the C&AG) and four non-executive members (including the Chairman).
- The C&AG should appoint the executive members of the Board, but such appointments should require the approval of the Board.
- The non-executive members of the Board should be appointed by the Commission, on a recommendation from the Chairman.
- The Chairman of the Audit Commission should attend the Board as an observer. His or her inclusion would contribute to closer co-operation between the NAO and the Audit Commission, which we would welcome, and would help to avoid inconsistent decisions. We would like this to be a reciprocal arrangement.

12. The non-executive members of the Board would not be employees of the NAO, but should be bound by the same rules relating to conduct as employees are.

Role of the Board

13. We have considered carefully the extent to which the C&AG should be constrained by the Board as regards the overall strategy of the NAO and control over resources. In our view it is important that the Board should not be able to prevent the C&AG conducting an audit which he or she considered necessary or oblige the C&AG to undertake an audit which he or she did not regard as of sufficient priority. For that reason, we believe the C&AG should continue to control the use of the NAO's resources for statutory audit purposes.

14. The Board should therefore set the overall strategy for the NAO, which would guide the balance of the C&AG's work programme, but the Board would not be able to prevent an audit of which it disapproved or require an audit to be undertaken. It would, however, be able to challenge such an audit or the lack of audit coverage. The inclusion of *non-statutory* work in the NAO strategy (for example international work) would require the agreement of the Board. We hope that there would in fact be a harmonious relationship between the C&AG and the Board, but corporate governance arrangements must make provision for possible disagreements.

Terms and conditions for the C&AG

Term limit

15. We agree with John Tiner that the C&AG should be appointed for a single non-renewable term. We consider it essential that the term is long enough for a C&AG to establish himself or herself and gain experience. John Tiner has proposed an eight-year term. We prefer a slightly longer term, of ten years.

Appointment process

16. We agree with John Tiner that the appointment of the C&AG should continue to be by a process which involves agreement between the Prime Minister and the Chairman of the Committee of Public Accounts (as provided for in the National Audit Act 1983), and also that the principles set out in the Code of Practice published by the Office of the Commissioner for Public Appointments should be followed.

Salary

17. We agree that linking the C&AG's salary to that of a High Court judge does not link the position to an appropriate peer group. We believe the salary should instead be comparable to that of the Treasury's Permanent Secretary and be linked to that pay level, but adjusted to reflect the bonuses available to the Treasury's Permanent Secretary rather than creating a bonus system for the C&AG. In the longer term we would like the salary to be reviewed in time for the term of the C&AG after next, with particular reference to the possibility of varying the salary in order to be sure of attracting the best candidate.

Subsequent employment

18. A single non-renewable term in place of the present unlimited tenure implies that a future C&AG might undertake a different employment after his or her term. It is obviously essential that subsequent employment could not be seen as a reward for actions taken while C&AG, and for that reason there should be a lifetime prohibition on a C&AG or former C&AG accepting any post in any body which the NAO has audited or which is in the gift of the Government. Apparent conflict of interest could also arise over some other posts in the private sector, for example with defence contractors or other suppliers to the public sector, and a C&G should be required under the terms of his or her contract to consult the Advisory Committee on Public Appointments (currently chaired by Lord Mayhew) before accepting any employment whatever after leaving the post of C&AG and to abide by the decisions of that Committee.

The C&AG's responsibility

19. We note that the C&AG's overall responsibility for audit judgments does not imply that all such judgments must be made by the C&AG. It is therefore possible for the C&AG to delegate the making of audit judgments to subordinates.

External auditors

20. We agree with the proposals in the review relating to the NAO's external auditors, subject to retaining the requirement that the Commission approve the auditors' appointment. Whereas currently the Commission appoints the external auditors, drawing on advice from the NAO, the new system would be as follows: the NAO's Audit Committee would recommend a firm to the Board, which, if it agreed, would appoint the firm, subject to approval by the Commission.

Next steps

21. Some of our proposals will require legislation, and the Government has undertaken to make provision in the Constitutional Renewal Bill for any proposals arising from the review with which it agrees. We will discuss such proposals with the Government. We will discuss with the NAO those proposals which do not require legislation.