

Response of the Auditor General for Wales to consultation on the draft Public Audit (Wales) Bill

1. I welcome the opportunity to comment on the Welsh Government's draft Public Audit (Wales) Bill. Any significant changes to public audit arrangements may have wide-ranging effects on the public's and Assembly Members' ability to hold Government to account. It is therefore appropriate that in pursuing legislation in this area the Government has put forward a draft Bill for consultation.
2. I attach a completed consultation response form, as requested by the Government. For ease of reference I have also set out below the main themes that I consider the Government should address before introducing a Bill into the Assembly. (I also attach a schedule of other matters that are not covered by the response form.) I am happy to provide further assistance to the Government to help it ensure that it introduces an appropriate Bill.

Summary

3. I am entirely in favour of legislation that would appropriately strengthen the governance arrangements of the Wales Audit Office and improve Assembly oversight. The actions of a former AGW in relation to severance arrangements and training expenditure demonstrated the weakness in existing statutory provisions, and I am keen that legislation is made to entrench and protect appropriate governance arrangements. I also welcome the fact that the draft Bill provides some useful development and tidying of audit provisions.
4. However, the corporate governance and PAC oversight arrangements that the draft Bill specifies are over-prescriptive and unbalanced. The arrangements specified by the draft Bill include detailed and extensive prescription of the activity of PAC in relation to the WAO. Unfortunately, such extensive activity would crowd out PAC's proper work of scrutinising Welsh public bodies. This would be likely to have a detrimental effect on Assembly scrutiny of Government and would weaken overall governance of the Welsh public sector. It is desirable to provide a stronger statutory basis for corporate governance arrangements for the WAO, but the model presented in the draft Bill is very problematic.

Over-prescription of the work of PAC to the detriment of Assembly scrutiny of Government

5. The draft Bill prescribes that PAC must consider not only the WAO's estimate (clause 10(4)) but also:
 - a) publish the WAO's annual plan¹ (clause 14);
 - b) consider not just one but two interim reports that include assessments against the annual plan (para 3 of Schedule 2);

¹ This is despite provision for the AGW and Chair of WAO to lay the plan before the Assembly, which as Assembly procedure requires all laid reports to be published by the Assembly in any case, appears to make this publication provision redundant. The same applies to the annual report at e).

- c) consider an annual report that includes an assessment against the annual plan (para 3(6)(a) of Schedule 2);
 - d) prepare its own reports in relation the interim and annual reports submitted to it and lay them before the Assembly (para 3(6) of Schedule 2);
 - e) publish an annual report (para 3(7) of Schedule 2);
 - f) approve a scheme for the WAO's charging of fees and lay it before the Assembly (clause 22);
 - g) lay before the Assembly the certified accounts of the WAO and reports of the auditor of the WAO, including a report on the results of the auditor's value for money examinations (para 29(9) of Schedule 1) .
6. While not prescribed by the draft Bill, PAC's activity would no doubt also include consideration of reports from the auditor of the WAO. If each report or other item takes up half a session of PAC, then PAC's activity in relation to the WAO would take up the equivalent of five and a half sessions a year, i.e. over a quarter of all scheduled sessions. All this PAC activity directed at the workings of the WAO would be at the expense of scrutiny of Government. It would also be disproportionate, as over 25 per cent of PAC scrutiny time would be directed at less than 0.1 per cent of Welsh public sector expenditure.
7. Appropriate oversight and scrutiny of the WAO is, of course, required, but a disproportionate level of such activity is clearly not necessary, as comparison with the arrangements for the NAO shows. While the NAO model includes provision for an NAO strategy to be submitted to the Public Accounts Commission (TPAC), there is no prescription of annual reports including assessments against the plan, let alone two interim reports. Similarly, there is no requirement for TPAC to approve a charging scheme for the NAO.
8. In this context, it should be borne in mind that the existence of a separate TPAC for dealing with NAO resourcing and oversight means that the Westminster PAC is better able to concentrate on holding Government to account in any case. The lack of a separate Assembly TPAC makes it even more essential that PAC is not overburdened with detailed consideration of the WAO. Indeed, I suggest that in addition to addressing the issue of over prescription of PAC activity, the Government should consider revising the bill so as to allow the Assembly to determine whether to have a separate oversight committee for the AGW/WAO (and perhaps other similar bodies, such as the Ombudsman).
9. I consider that the PAC oversight provisions should be made more proportionate and less likely to consume too much Assembly scrutiny time by providing just for an annual plan integrated with the estimate, which should encompass arrangements for charging fees and reporting against the previous year's estimate. PAC, or an oversight committee, would then be able to consider AGW's/WAO's estimate and business plan in one integrated package. (This would be in addition to the laying of the WAO's annual accounts and the reports of the auditor of the WAO.) Such provisions would make the Assembly's consideration of the

running of the WAO more streamlined and proportionate, and would prevent the loss of valuable time needed for scrutiny of the Welsh Government.

Over-prescription of the workings of the WAO to the detriment of independent audit

10. The draft Bill would not only require PAC activity in relation to the WAO's annual plan, interim reports, annual report and scheme of charges in addition to the estimate, but it would also require all those items to be either agreed between the WAO and the AGW or jointly prepared by the AGW and the Chair of the WAO. Again, such extensive prescription is not present in the NAO model, and the NAO legislation² does not include the awkward provision for agreement between the AGW and the board. Such legislation for agreement may lead to significant delay in decision-making, or, worse, may lead to AGW giving way on his or her assessments that certain matters in the Welsh public sector should be examined. It will therefore fetter the AGW's audit independence. The House of Commons TPAC made clear that business planning arrangements should not impinge on the Auditor General's statutory functions and discretion in its report *Draft clauses on the corporate governance of the National Audit Office* (HC1027, 24 July 2008):

Audits which the C&AG is statutorily obliged to perform will necessarily be included in the programme, and the C&AG will decide on a programme of value for money examinations. The intention is that the Board may discuss the C&AG's proposed programme of value for money work, and may challenge particular proposals or the balance of the programme, but decisions about its content will be taken by the C&AG.

11. The extensive prescription of interim reports etc would consume WAO's resources at the expense of examination of Welsh public bodies' stewardship of public resources. Again, the effect would be detrimental to effective scrutiny of Government. I suggest that the provisions for producing an estimate, annual plan and outturn report should be more streamlined and proportionate. The arrangements should also provide protection for statutory audits and the AGW's discretion in terms of deciding on programmes of value for money examinations, as identified as necessary in respect of the C&AG by the House of Commons TPAC. In particular, I consider that the AGW's ability to undertake independent audit work should be bolstered by revising the bill so that the board is empowered to challenge the content of the AGW's work programme by asking questions about it and giving its views rather than being required to agree the programme. Requiring the AGW to respond in a timely manner to such questioning would be sufficient to make the arrangements robust without undermining the AGW's independence.
12. In addition to the over-prescription of WAO's internal administration mentioned above, the draft Bill would require the AGW to request resources from the WAO board for the exercise of his or her functions. Such requests would have to specify the purpose for which the resources are required and an estimate of their extent. The draft Bill then specifies the application of a reasonableness test by the WAO board for deciding on such requests. This would effectively duplicate the estimate process already provided by PAC, so wasting public

² The Budget Responsibility and National Audit Act 2011

resources, but with the added complication of a reasonableness test. Such a reasonableness test may well lead to extensive and expensive disputes between the AGW and the WAO board. Indeed, I was deeply concerned that, when questioned about this matter by the PAC on 1 May 2012, the Welsh Government witness responded by referring to the ability of the AGW to take legal action against the WAO. As a proposed mechanism for dispute resolution, this surely would not amount to a sensible use of public funds. I also consider that in governance terms it is not tenable, as in order to pursue an action, the AGW would need to request the necessary resources from the WAO, triggering at least one major conflict of interest.

13. The NAO legislation does not provide for such additional bureaucracy. The NAO model only provides for the NAO board to have a gatekeeping role in respect of resources required by the C&AG for services that are outside his or her main statutory functions. With the draft Bill, the WAO board would have a gatekeeping role for all the AGW's functions, which is an inappropriate fettering of the AGW's ability to secure resources for his or her core statutory functions, including, of course, examination and scrutiny of the Welsh Government. This point about auditor independence was well made by the House of Commons TPAC (HC1027, 24 July 2008):

For the C&AG's responsibility for forming audit judgements to be meaningful, he or she needs to control the use of resources for statutory audit purposes. While resources will always be limited in a general sense, artificial constraints on the use of resources for statutory audits could influence the scope of the work and thus indirectly the judgements reached.

14. I suggest that this problem should be best addressed by revising the bill so that the AGW continues to employ his or her own staff and procures his or her own professional services, and that the board has a statutory supervisory, challenge role. Such a supervisory board should be statutorily empowered to require the AGW to inform it, or its committees, of significant business decisions in advance of their implementation and to provide business information, including in relation to all expenditure. Such information would encompass, for example, information in relation to severances and training. A board clearly focused on challenging the AGW to demonstrate appropriate use of his or her resources and exercise of his or her functions would also reduce the need for PAC to undertake extensive work in that role. Indeed, such a board, by negating the need for such extensive work on the part of PAC, but still having a line of communication to the PAC to raise matters of concern, would prevent the loss of valuable PAC Government scrutiny time.
15. If, however, there is to be a corporate WAO, then, as with the NAO model, the WAO board should be simply required to provide the resources required by the AGW for his or her core statutory functions and only have a gatekeeping role in respect of resources needed for ancillary non-core work, such as overseas work.

Inappropriate board functions and mismatch in board composition

16. The WAO board composition set out in the draft Bill is not appropriate for the functions that the board would have under the draft Bill. There is a mismatch between the strong executive role envisaged for the WAO board in the running of Welsh public audit—deciding (albeit in agreement with the AGW) work programmes, employing staff and procuring professional services—and the board’s largely non-executive composition, which is more suitable for a supervisory, holding to account role. From the point of view of independent audit, having a WAO board with a strong executive role in the running of Welsh public audit would be more of a problem than the largely non-executive composition of the board. I suggest that the mismatch is addressed by revising the provisions so as to create a supervisory board, as set out above. However, if audit independence is to be sacrificed, then the board composition set out in the bill is likely to lead to the worst of both worlds, as the non-executive preponderance will lead to a lack of suitably experienced and engaged management input.
17. The draft Bill provides for the WAO to employ staff on terms broadly in line with the staff of the Welsh Government. The broad alignment of terms is not problematic *per se*, but it would be a helpful safeguard if this were subsidiary to a requirement on the AGW/WAO to employ adequate numbers of suitably qualified professional staff. As it is, the consultation document only says, “the WAO may include amongst its employees appropriately qualified auditors to assist the AGW with the exercise of his or her audit etc functions.” This is a rather strange statement, as qualified auditors are *essential* for ensuring proper audit scrutiny. Among other things, this is required by the International Standards on Auditing (ISAs)³.
18. If the WAO, rather than the AGW, were to employ staff then the Bill would need to make specific provision for ensuring appropriate professional qualifications and standards among staff to the AGW’s satisfaction. In particular, it would be appropriate under that arrangement if there were provision for the AGW to engage independent professional support directly, rather than through the WAO, in order to be satisfied that the staff of the WAO working for him or her have the competence, capabilities and commitment to ethical principles necessary to meet professional standards⁴. This is especially important as it is the AGW, rather than the WAO, that will be providing audit opinions. However, such dual resourcing would be likely to lead to great complexity in terms of supply arrangements (finance) and HR, and so the better and indeed simpler solution would be for all staff to be employed by the AGW, as he or she can then directly ensure compliance with applicable professional standards.

³ See ISQC1 paragraphs 29 and A24 to A31, and ISA220 paragraph 14. For interpretation of the application of ISAs in the public sector, see the Auditing Practices Board Practice Note 10.

⁴ See in particular Paragraph 29 of ISQC1.

Inappropriate provision for the appointment of the auditor of the WAO

19. The draft Bill provides for the WAO to appoint its own auditor, albeit with the agreement of PAC. Appointing one's own auditor is poor practice, as the benefit of being appointed is a consideration that reduces the independence of the auditor. Bodies appointing their own auditors has been recognised as poor practice as long ago as the Layfield Committee considered public sector audit in 1976. I suggest that the provisions are revised so that the auditor is appointed by PAC.

Some useful tidying of audit provisions and other improvements, but there is scope for more

20. The draft Bill provides some useful tidying of the currently scattered audit provisions. This tidying will help provide greater consistency in audit across the Welsh public sector. The provision for the AGW to be the auditor of local government bodies should help provide greater clarity for the public in terms of knowing who they can raise concerns with. However, this benefit of clarity is rather spoiled and outweighed by the fettering of the AGW's functions that would be provided by the draft Bill through the prescription of a requirement to agree work plans and the proposed WAO board gate-keeping role.
21. The provision for the AGW to audit the accounts of further and higher education corporations if requested to do so, and if not requested to do so, to advise on the appointment of another auditor, is a step in the right direction (clauses 34 and 35). The provisions should help to ensure consistent and rigorous audit standards in the education sector.
22. However, clause 34 still essentially allows both further and higher education corporations to appoint their own auditors, which, as mentioned above is poor practice. And in relation to Further Education institutions, it is a matter that has been raised by the (then) Assembly's Audit Committee in relation to corporate governance failings in the Welsh further education sector since 2000. Similarly, the opportunity has not been taken to provide for the AGW to have an unfettered ability to undertake vfm examinations in relation to registered social landlords (housing associations). I suggest that the Welsh Government re-examines these opportunities to improve audit arrangements in the Welsh public sector.

Conclusion

23. While there are elements of beneficial change in the draft Bill, the over-prescription of the activity of PAC and the creation of a corporate WAO with a heavy gatekeeping role in relation to the AGW's functions does not serve to help the Assembly and the public to hold Government to account.