

## AUDIT AND ACCOUNTABILITY

### THE GOVERNMENT RESPONSE TO LORD SHARMAN'S REPORT "HOLDING TO ACCOUNT"

#### A SUMMARY OF THE ISSUES

#### **Background**

Over the years the Committee of Public Accounts (PAC) have expressed concern that the remit of the Comptroller and Audit General (C&AG) had become artificially restricted. In the light of debate in 2000 on the Government Resources and Accounts Bill, the Chief Secretary to the Treasury asked Lord Sharman to conduct an independent review of audit and accountability in Central Government. Lord Sharman published his recommendations in February 2001 in his report titled "Holding to Account". The PAC and the Public Accounts Commission (TPAC) have announced their approval of the report. Given the wide-ranging implications of Lord Sharman's recommendations the Government consulted departments and NAO at length. The Government response was published on 14 March 2002.

Copies of the Government response "Audit and Accountability in Central Government: The Government's response to Lord Sharman's report *Holding to Account*" have been sent to Government departments, including separate copies to pass on to sponsored executive NDPBs. The response is also available on the Treasury website ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)) in PDF form and additional hard copies can be purchased from the Stationery Office at £10.75.

Definitions that explain references to audit, value for money examinations and access are provided below.

#### **Content**

Lord Sharman made 21 recommendations in his report. Twelve of those recommendations were addressed mainly to the Government and 9 mainly to the PAC, TPAC and the C&AG. The Government has accepted all of Lord Sharman's main recommendations and supports those recommendations addressed to others.

The main points from the Government response are:

- The C&AG should be the auditor of all NDPBs, subject to arrangements which will be put in place to ensure that there is no reduction in the level of assurance that is currently provided to sponsoring departments and NDPB Boards;
- The legal barriers to the C&AG's eligibility to audit companies should be removed so that he can audit companies which are also NDPBs or subsidiaries of NDPBs;
- The C&AG should have statutory access to documents held by grant recipients, registered social landlords (previously housing associations), train operating companies, contractors and sub-contractors where it is

needed to conduct an audit or vfm examination of a body that he audits. Such access will be accompanied by protocols, agreed between the Government and the NAO, to ensure access is exercised with full regard to the need for prior consultation and to minimise additional burdens.

- New arrangements for external validation of data systems underpinning Government performance targets will be introduced. The C&AG will be invited to undertake this work, taking account of the work of others, notably the Office for National Statistics and the Audit Commission.
- Continuing emphasis on robust structures of risk management and internal control in departments and NDPBs;
- The introduction of measures to promote quality and transparency in central government audit processes, including arrangements by the NAO to establish a customer care line;
- To maintain the impetus of the Sharman proposals, the establishment of a high-level Audit Liaison Group jointly chaired by the Permanent Secretary of the Treasury and the C&AG.

### **What is Audit and Access?**

An **Audit** of a central government body entails an examination of a body's financial affairs to enable the auditor to express an opinion on whether the body's financial statements present a true and fair view of its state of affairs. The opinion also covers whether the financial accounts have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions thereunder and whether in all material respects the expenditure and income have been applied for the purpose intended by Parliament and the financial transactions conform to the authorities that govern them.

**Vfm examinations**, which the NAO have the right to conduct under the National Audit Act 1983, are examinations into the economy, efficiency and effectiveness with which a body has used its resources in discharging its functions. Examinations may cover a whole department, a particular activity or a theme that spans Government.

**Access** is a term used in two main ways. First it applies to the C&AG's access to documents held by those bodies in which he is carrying out an audit or vfm study. Second it refers to the occasional need of an auditor to see documentation held by a body outside the department or NDPB that is being audited or that is being subjected to a vfm study. This access allows the C&AG independently to examine and validate documents held by bodies outside the audited body. Such access does not allow the NAO to conduct an audit or vfm examination of these external bodies. Where Lord Sharman and the Government response refer to GRAA access orders it is this second type of access that is intended.

### **Next Steps**

The Government will shortly be consulting departments, NDPBs and other bodies on the proposed Government Resources and Accounts Act Orders. That consultation will include an assessment of the impact of the Orders on bodies affected by them. In the light of responses to the consultation, the Orders will then be drafted and made.

The Treasury and NAO will establish the proposed Audit Liaison Group and will determine its membership and terms of reference. Departments will be consulted on the establishment of the group and on its work programme.

Guidance documents to support the access protocols, the establishment of the NAO customer care line and other arrangements will be drawn up and issued in consultation with the NAO. Departments and others will be consulted on the guidance documents where appropriate.

### **Some details**

#### *Audit*

The C&AG already audits the vast majority of NDPBs and the Government's policy has been to appoint him as the auditor of all new executive NDPBs since 1997. Lord Sharman's proposals would bring into line those few NDPBs which, for historical reasons, have not been audited by the C&AG. Changes would be implemented through orders under the Government Resources and Accounts Act 2000 (GRAA) and as existing audit contracts expire. Housing Action Trusts would not be covered by the Order as they are due to be wound up shortly.

The C&AG will initially contract out at least an equal number of additional audits as are currently awarded to private firms by departments.

The C&AG will subject the NAO to scrutiny by the Joint Monitoring Unit (JMU) of the Professional Institutes of Accountancy, thereby subjecting the NAO to the same scrutiny process used for private sector accountancy firms, and will share the conclusions with departments. The C&AG will also make the conclusions of the London School of Economics assessments of the NAO's published vfm reports available to departments. The C&AG will further develop existing arrangements to obtain feedback on the quality of NAO's work.

The C&AG's powers to audit companies as a Companies Act auditor depends on the resolution of legal issues. Once the legal barriers to the C&AG's audit of companies are removed, he should become the auditor of NDPBs, and their subsidiaries, that are companies.

#### *Access*

The C&AG already has non-statutory access to documents held by a wide range of bodies. Lord Sharman's proposals would place that access on a statutory basis.

The Government will go beyond Lord Sharman's proposals on access by providing statutory access to documents held by all contractors to government rather than just PFI contractors. In addition, there will be no minimum threshold for access.

The C&AG has given a commitment to balance its work to avoid excessive workload on any individual body. The new access and inspection rights will not increase the audit load on publicly funded bodies as a whole.

The Government is accepting Lord Sharman's recommendation for there to be new access to documents held by train operating companies.

Access does not provide the right to carry out financial audits or to do value for money studies of private sector bodies. Access will only be to those documents required for the audit, or a vfm examination, of a body audited by the C&AG.

The Government reserves the right to exclude bodies from the statutory access arrangements. Such exemptions will only occur in very limited circumstances where the Government is concerned that granting access would run counter to key policy or legal concerns. Any exclusions would be revisited from time to time.

The Government is not accepting Lord Sharman's recommendation that the 1999 Davies Report recommendations about the BBC, rejected by the Government at that time, should now be implemented to entitle the C&AG to carry out value for money studies of the BBC.

#### *Other*

The Government supports Lord Sharman's recommendations on improved internal control and on promoting a culture of well-managed risk.

The Government does not accept that all departmental audit committees should consist entirely of non-executives. An Accounting Officer should continue to determine how best to organise the Audit Committee to suit the needs of the department.

#### **Contact details**

Queries about Lord Sharman's review which are not answered in this document or by the text of the Government's response should be addressed to Lorraine Constable in the TOA Team at the Treasury (telephone 020 7270 5361. Email [lorraine.constable@hm-treasury.gov.uk](mailto:lorraine.constable@hm-treasury.gov.uk)).