



Date: 5 September 2012  
Our ref: HVT/1718/fgb  
Page: 1 of 24

Mr Darren Millar AM  
Chair, Public Accounts Committee  
National Assembly for Wales  
Cardiff Bay  
CF99 1NA

## PAC INQUIRY INTO THE GENERAL PRINCIPLES OF THE PUBLIC AUDIT (WALES) BILL

1. I am very grateful for the Committee's invitation to provide evidence to support its inquiry into the principles of the Public Audit (Wales) Bill. I welcome the stated intention of the Bill to place the governance arrangements of the Wales Audit Office onto a statutory footing. I do, however, have some points of concern regarding the Welsh Government's proposals, which I set out below. I also attach comments on individual clauses at annex A and a summary of the financial implications of the Bill at annex B. Annexes C and D provide further comments in respect of governance models. I hope that this material will be of assistance to the Committee in drawing up its report on the Bill.

### **Legislation to strengthen the governance and accountability of the Wales Audit Office would be beneficial**

2. I believe that it would be beneficial to have legislation to strengthen the accountability and governance arrangements relating to the office of AGW and the Wales Audit Office. In particular, I think it is highly appropriate to establish a board for the WAO on a statutory basis, as this will enable the firm institution of governance arrangements to provide oversight of the AGW and senior management of the organisation. This would overcome the principal weakness of the current legislation, which is that while it enables the AGW to establish governance arrangements, such as advisory committees, it also enables the AGW to abandon or bypass them.

### **The proposals in the Bill, however, present some significant problems**

3. While the broad intentions behind the Bill are sound, the detailed proposals are rather problematic. Most fundamentally, the Bill provides for a WAO board with executive functions of running the audit office, while at the same time specifying that the board will consist predominantly of non-executive members. The proposed board therefore falls between two objectives—oversight of the AGW (the function of a 'supervisory' board)

and running the Audit Office (the function of an ‘executive’ board)—and is likely to serve neither particularly effectively. The oversight functions of the proposed board will also be compromised by its executive functions.

4. While the proposals have some similarities with the UK National Audit Office’s arrangements, there are substantial differences. For example, with the NAO, a statutory code deals with the relationship between the Comptroller & Auditor General (C&AG) and NAO board. This code applies to the preparation of a strategy and estimate of income and expenditure by the C&AG and NAO board, and other key activities, and it is required to reflect the C&AG’s audit independence. The existence of this code is an indication of the need to manage the tension that the corporate body places on the C&AG’s independence. There is no equivalent provision for such a code in the Bill. Instead, the Bill prescribes procedures and gives the WAO board functions that undermine the audit independence of the AGW.
5. In addition, the provisions in the Bill for the transfer of staff to employment by the WAO board may sow the seeds for legal disputes. And more widely, the proposals are likely to be more expensive than as set out in the Government’s Explanatory Memorandum.
6. I explore these issues further below, along with some suggestions for addressing them either by making the WAO board focus on supervisory functions or by making it an executive board with a more appropriate composition.

**The board as proposed in the Bill will not have enough executive members to ensure effective exercise of its executive functions**

7. The WAO board is to have a composition that is predominantly “non-executive”: 5 non-executives versus the AGW, with an employee member to “ensure that employee experience is able to inform the board’s activities and actions” (Schedule 1 (para 1)). This is highly problematic because while such composition might be appropriate for a supervisory board, the Government intends that the board has executive functions of running the organisation, such as employing staff and agreeing the annual plan. The proposed composition, however, means that the board does not have a sufficient number of executive members to ensure that senior managers responsible for implementing decisions have a meaningful share of ownership in those decisions. This contrasts with the composition of the NAO board, which has three employee members, who, as they must be recommended by the C&AG, the C&AG may ensure are appropriate senior managers.

**A supervisory-type board would be a more cost-effective option, allowing robust oversight of the Auditor General**

8. I believe that it would be best if the board’s functions were focused on supervisory functions, rather than also having functions of running the organisation. This would allow the board to concentrate on considering whether the AGW was running the organisation properly and advising the AGW and the Assembly accordingly, rather than being compromised in that important oversight role by taking part in decisions on the running

of the organisation. As set out in annex C, the board's functions could include advising the National Assembly in support of its consideration of the AGW's estimate and annual reporting, and reporting as and when required to the National Assembly on any matters of concern regarding the AGW. This would strengthen oversight beyond the level provided by a corporate body, and it would help alleviate the detailed oversight burden on the National Assembly.

9. Focusing on supervisory functions would also probably be a more affordable option, as the board members' fees would not need to include a component to recognise their decision-making responsibilities. Certain significant costs arising from implementation, including the costs of transferring staff, assets and liabilities, would also not be incurred (see para B13 of annex B), and implementation would be more straightforward and quicker to achieve than with a corporate body board.

**If an executive board is to be implemented, then significant changes to the Bill are needed to make it fit for purpose**

10. If, however, the Welsh Government's preference to have a board to run Wales' audit organisation is to prevail, changes will be needed in the Bill in relation to the composition of the board to make it fit for purpose. In particular, such a board should have sufficient executive members not just to inform decisions but also to ensure that those responsible for implementing decisions have a meaningful share of ownership in those decisions. It would also be appropriate to make changes to address some of the risks and costs that may arise from the employment and transfer arrangements as currently drafted. Further details of more workable corporate body arrangements than those set out in the Bill are at annex D. It is, however, likely that any corporate body option will be more expensive than a supervisory board because of the need to pay board members a greater rate to reflect responsibilities relating to the running of the organisation and because of the expense of implementing a transfer of staff, assets and liabilities (see para B14 of annex B).

**Under the Bill, audit independence will be undermined by the board's ability to reject the AGW's work programme, while the requirement for agreement is potentially unworkable**

11. Confidence in auditing rests to a great degree on the independence of the auditor, and independence is a key requirement of international and UK ethical and professional auditing standards. Historically, the importance of audit independence has been reflected in the constitutional position of Auditors General in western democracies. The Welsh Government appears to recognise that this is an issue in some features of the Bill. At clause 26 they have sought to temper the WAO board's ability to interfere in the AGW's judgements about his work programme by stipulating that the WAO board is only able to reject the AGW's statement of his work programme if the statement, or a part of it, is "unreasonable". Unfortunately, this is not adequate protection of the AGW's audit independence, as the clause still allows the WAO board to reject the AGW's judgement of what matters merit examination.

12. Clause 26 is also problematic in that it raises the prospect of dispute without providing a means of resolution. Other than compromise, the only realistic means of resolving a difference of opinion on the work programme is the resignation of either the AGW or other members of the board. The suggestion that differences could be resolved in court, as put forward by the Welsh Government to PAC on 1 May 2012, is not a practical proposition because of the innate conflict of interest that stems from AGW having to rely on legal advice contracted to the WAO.
13. The specific requirement for agreement of the overall annual plan under clause 25 also undermines audit independence. Requiring agreement makes it likely that there will be a need for compromise, and this compromises the audit independence and judgement of an Auditor General.
14. These problems could be avoided through adopting the model of a supervisory board. Alternatively, they could be better managed if the Bill followed the NAO arrangements more closely, particularly if it required a code to protect the AGW's independence in key decision-making activities.

**The audit independence of the AGW will also be undermined by the board's ability to shape the exercise of the AGW's functions**

15. For the AGW to delegate his or her work, which is a practical necessity, under clause 18(2) he or she must have a scheme of delegation approved by the WAO board. This brings the board into the details of the running of the organisation, and is a significant potential constraint on the way the AGW exercises his or her functions. It could, for example, prevent the AGW participating in the UK-wide National Fraud Initiative, and this is explored further in paragraphs A37 to A41 in annex A.
16. Conversely, under clause 19, the WAO board is given the power to arrange with public bodies for the AGW to provide services to those bodies. But this clause does not require the AGW's agreement—AGW may be outvoted by the rest of the board. The clause could therefore lead to significant conflicts of interest that would undermine the AGW's audit work. For example, the WAO board could arrange, despite the AGW's opposition, for the AGW to provide the payroll administration of a body that he audits. This would be a major ethical issue and would contravene international professional standards as it would involve the AGW auditing services that he himself has provided.
17. Under clause 21 and para 20 of Schedule 1 the WAO board is to be the employer of all WAO staff, and clauses 14 and 21 give it other functions such as "securing" services. This further constrains the AGW's ability to meet professional requirements. In particular, the AGW (who is the person who will provide audit opinions) will not be able to employ anyone directly to assess the quality of staff and services provided by the

WAO board (this is precluded by clause 9(2)), and this is a potential barrier to compliance with international professional standards<sup>1</sup>.

18. The problems of ensuring appropriate staff support for the AGW might to some degree be overcome if the board delegated to the AGW, as Chief Executive of the organisation, the authority to institute measures such as engaging independent quality assurance inspections. As the Bill is currently drafted, however, the necessary authority is not guaranteed, and this raises a wider issue of a lack of balance of authority with responsibility and accountability. The AGW will bear the ultimate responsibility of delivering audits and studies without the full authority to meet those responsibilities.

**The Bill does not provide adequate TUPE- equivalent safeguards for the staff transferring to the new WAO, and this may lead to expensive legal disputes**

19. Staff employed by the AGW are to be transferred to employment by the proposed WAO board (para 5 of Schedule 3). The transfer scheme does not provide the same protection as the TUPE regulations (see para A33 of annex A), and it is unlikely that the TUPE regulations themselves apply. The Bill therefore seems to be at odds with the Welsh Government's statement in para 242 of its consultation document on its draft bill of 15 March 2012 that "provision will be made so that the transfer of employment will be on no less favourable terms than would be the case if TUPE applied".
20. In addition, the requirement for the proposed WAO to ensure that terms of employment are broadly in line with those of the Welsh Government (para 20 of Schedule 1) creates a tension if any terms of transferring staff are found not to be broadly in line with Welsh Government terms (see paras A14 and A15 of annex A). We have asked the Welsh Government for clarification of its intentions in this area. In any event, however, the Bill as drafted is not clear on this matter, and this may be a recipe for expensive legal dispute.

**The cost of the Bill as it stands is likely to be significantly higher than that estimated in the explanatory memorandum**

21. The corporate body put forward in the Bill will inevitably incur costs. I estimate that the set-up and transitional costs (including the AGW's costs of the Bill itself) would lie between £180,000 and £350,000, and that the ongoing annual recurring cost lies between £200,000 and £650,000, with something nearer the lower figure more likely but not guaranteed (see annex B for further details). The higher ongoing cost figures largely reflect the risks of disputes, taxation of travel and subsistence expenses, and the possible need to bring employment terms closer in line with Welsh Government terms, all of which stem from the proposed transfer of staff from employment by the AGW to employment by the WAO board. The cost of the board itself in terms of such things as

---

<sup>1</sup> International Standard on Quality Control 1 (ISQC1) and International Standard on Auditing (ISA220), as applied through Practice Note 10

Date: 5 September 2012  
Our ref: HVT/1718/fgb  
Page: 6 of 24

board members' fees is also likely to be higher than as set out in the Welsh Government's Explanatory Memorandum.

22. I should be very happy to provide further information to the Committee to support its inquiry so as to help ensure that the Bill develops into legislation that is fit for purpose.

A handwritten signature in black ink, appearing to read 'Huw', followed by a stylized signature that likely represents 'Huw Vaughan Thomas'.

**HUW VAUGHAN THOMAS**  
**AUDITOR GENERAL FOR WALES**

## Comments on individual provisions of the Bill

### Sections 2-12—the Auditor General for Wales

- A1. In my view clauses 2 to 7 make sensible provision for the continuation of the office of the AGW, and the appointment, resignation, removal, disqualification, restrictions on subsequent employment, status and remuneration of the AGW.
- A2. Clause 8 provides that the AGW has complete discretion as to the manner in which his or her functions are exercised and is not subject to the direction or control of the National Assembly or Welsh Government. My concern is that this is a shade less explicit than the equivalent provision for the UK's Comptroller & Auditor General (C&AG) (section 17 of the Budget Responsibility and National Audit Act 2011—the BRANA Act), which makes clear that the C&AG has complete discretion in the carrying out of functions (not just the manner), including, significantly, in determining whether to carry out value for money examinations:
- 17 How functions are to be exercised*
- (1) The Comptroller and Auditor General has complete discretion in the carrying out of the functions of that office, including in determining whether to carry out an examination under Part 2 of the National Audit Act 1983 and as to the manner in which any such examination is carried out.*
- A3. I should prefer clause 8 to reflect something like the reference to examinations in section 17 of the BRANA Act.
- A4. Clause 9(1) makes appropriate provision for supplementary powers for the AGW, but clause 9(2) prohibits the AGW from doing anything that is the responsibility of the WAO board under clause 21(2)(a) to (c), which includes employing staff and securing services. As it is not clear what exactly “employing staff” and “securing services” mean in this context, this potentially undermines the ability of the AGW to perform functions delegated to him by the proposed WAO board (delegated under para 29 of Schedule 1), which would undermine his position as Chief Executive. For example, it is not clear whether the AGW will be able to instruct contractors to undertake tasks at particular times or else have their contracts terminated. This is a further potential impediment to AGW's participation in the National Fraud Initiative, as set out in paragraphs A37 to A41 below. There is no equivalent of clause 9(2) in the NAO's legislation (the BRANA Act 2011).
- A5. Clause 10 requires the AGW to issue a code of audit practice prescribing the way in which the functions of the AGW are to be carried out. Such a code has considerable merit, as it provides a basis for the AGW to ensure audits are undertaken by staff and contractors to a good standard. However, as drafted, the proposed scope of the code is excessively wide and covers matters that go well beyond audit practice. For example, it covers the provision of

advice and assistance to registered social landlords under section 145D of the Government of Wales Act 1998. This unnecessarily wide scope is likely to lead to a voluminous code that will be more expensive than necessary to prepare and maintain, and which may be hard to follow. I would therefore suggest that the clause is amended so as to omit 10(2)(c)(ii) to (vi), 10(2)(d)(iii) and 10(2)(e)(i). The last reference concerns the AGW's statutory rights of access to documents. The requirement to include prescription covering the exercise of such rights in a code of audit practice is likely to be counterproductive as it would be an item on which persons seeking to avoid their access obligations could try to challenge the AGW's statutory access rights, potentially delaying audits and increasing their cost.

- A6. Clause 11 makes the AGW the auditor of local government bodies in place of appointed auditors. At the moment, the presence of two auditors in local government leads to confusion and frustration among the public, and so this clause should helpfully enable greater clarity.
- A7. Clause 12 appropriately provides for the AGW to be consulted before Welsh Ministers transfer supervisory functions to the AGW. This should help prevent functions that are incompatible with the AGW's independence being transferred.

**Clauses 13-28— the Wales Audit Office and its relationship with the AGW**

- A8. Clause 13 establishes a new WAO as a corporate body, which is to be an additional public body intertwined with the AGW, who will continue to be a public body. Clause 13 introduces Schedule 1, which details the nature of the WAO, and elements of this are problematic.
- A9. Schedule 1 (para 1) gives the WAO board a composition that is predominantly “non-executive”. This is problematic because the board is to have functions of running the organisation (e.g., employing staff etc, as set out in clause 21 and agreeing the annual plan (clauses 25 and 26)). The proposed composition would mean that the board did not have a sufficient number of executive members to ensure senior managers charged with implementing decisions had a sufficient share of ownership in those decisions. (The board composition would not be so problematic if the board were not to have functions relating to the running of the organisation.)
- A10. Under para 1 of Schedule 1 one member is to be an employee of the WAO. The Welsh Government's explanatory notes indicate that this person is “to ensure that employee experience is able to inform the board's activities and actions.” This statement, together with the provision that the employee member is to be appointed by the non-executive members, indicates that there may well be no senior management member, such as a director of finance, on the board. This means that other than the AGW, who is to be the Chief Executive, there would be a lack of members with responsibility for implementing the board's decisions. This contrasts with the composition of the NAO board, which has three



employee members, who, as they must be recommended by the C&AG, the C&AG may ensure are appropriate senior managers.

- A11. It is also not clear how the employee member is to be appointed by the non-executive members “on merit”, as required by para 2(2) of Sch 1. The lack of clarity on this point may lead to disputes between the board and the WAO workforce, causing expense, and loss of efficiency and effectiveness.
- A12. If a supervisory board is to be pursued, then it would be appropriate for the legislation to provide criteria for the basis of the appointment of the employee member to reflect employees’ interests and experience. If, however, a board with executive functions is to be pursued, I would suggest that it would be preferable for there to be at least two employee members who would only be appointable if recommended by the AGW. This would enable the AGW to ensure sufficient management representation on the board, while maintaining a non-executive majority.
- A13. Para 20 of Schedule 1 and clause 21 make the WAO board the employer of staff, and clauses 14 and 21 give it other functions, including securing services. As the AGW (who is the person who will provide audit opinions) will not be able to employ anyone directly to assess the quality of staff and services provided by the WAO board (this is precluded by clause 9(2)), this is a potential barrier to compliance with international professional standards<sup>2</sup>. Those standards require, among other things, the AGW to establish policies and procedures to provide the AGW with assurance that he or she has sufficient personnel with the necessary professional competence and commitment to ethical principles. This might be overcome if the board were to delegate to the AGW, as chief executive of the organisation, the authority to institute measures such as contracting in independent quality assurance inspections. As the Bill is currently drafted, however, the necessary authority is not guaranteed because it is entirely at the discretion of the Board.
- A14. Para 20 of Schedule 1 also requires that the proposed WAO ensures that staff terms of employment are “broadly in line” with those of the members of staff of the Welsh Government. Aside from the question of whether the Welsh Government is an appropriate comparator (generally, the work of the WAO is quite different from the work of the Welsh Government), this provision is ambiguous but still prescriptive enough to cause problems. As “broadly in line” is not defined in the Bill or anywhere else, it leaves the WAO open to ongoing uncertainty, which would be exacerbated every time the Welsh Government changed its terms. In particular, the WAO would be exposed to potential judicial review claims from staff, trade unions or pressure groups. It might be assumed that “broadly in line”

---

<sup>2</sup> International Standard on Quality Control 1 (ISQC1) and International Standard on Auditing (ISA220), as applied through Practice Note 10

has the meaning that a reasonable person would give the phrase, and on that basis I believe the existing terms of my staff are broadly in line with those of the Welsh Government. However, there is no guarantee that a Judge would be of the same view.

- A15. To address this, I strongly suggest that if there is to be any “broadly in line” provision, then it should follow the more pragmatic wording set out in para 17 of Sch 2 to the BRANA Act 2011:

*In determining the terms of employment of any staff, NAO must have regard to the desirability of keeping the terms broadly in line with those applying to civil servants.*

(Emphasis added)

This would much reduce the risk of judicial review and consequent public expense.

- A16. As noted in my response to the consultation on the draft bill, the disqualification provisions for members of the WAO (para 24 of Schedule 1) would be made more relevant by including members or employees of bodies audited by the AGW.
- A17. The phrase in para 31(5) of Schedule 1, “as that person considers appropriate” in relation to the auditor of the WAO’s accounts, seems to provide too much latitude and may result in poor quality audit.
- A18. Conversely, para 32(3) of Sch 1 should have the words “in all material respects” added after “satisfied” so as to ensure that the legislation provides for a realistically achievable audit that is in line with professional auditing standards.
- A19. Clause 16 makes the AGW the Chief Executive of the WAO, para 1 of Sch 1 to the Bill makes the AGW a WAO board member, and para 30 of Sch 1 makes the AGW the Accounting Officer of the WAO. The AGW therefore holds four key roles: (a) as Auditor General, the person who is ultimately responsible for delivering audits and studies, (b) as Accounting Officer, the steward of the organisation’s resources, (c) as Chief Executive, the chief manager of the organisation and (d) as board member, a participant in board discussion and decisions. There is no innate contradiction between roles (a) to (c), but there are problems with them in the proposed executive board set-up. Under the proposed set-up, the AGW, as Chief Executive is subject to the decisions of the board regarding the work programme, its resourcing and the general running of the organisation. Therefore, as Chief Executive, his ability to meet his professional requirements as Auditor General is constrained by the need for board agreement on key management issues, such as the recruitment and training of staff.
- A20. Furthermore, the AGW will bear the ultimate responsibility of delivering audits and studies without the full authority to meet those responsibilities. This ultimate personal responsibility

also extends to regulatory requirements, such as compliance with the Data Protection Act, and again with the same lack of full authority.

- A21. Unlike with the NAO, the Bill does not provide a code that may help ameliorate the innate tensions arising from having an auditor general within and subject to a corporate body board. Para 10 of Sch 3 to the BRANA Act provides for a code to deal with the relationship between the C&AG and the NAO, and this is specifically required to reflect the principles set out in section 17 of the BRANA Act (see quote at A2 above), i.e. the C&AG's complete discretion in the carrying out of functions. The code is an indication of the need to manage the tension that the corporate body places on the C&AG's independence.
- A22. Clause 16(2) introduces Schedule 2, para 1 of which requires AGW and the chair of the WAO to jointly prepare annual and interim reports. As with the joint preparation and laying of estimates (clause 20), joint laying of the annual plan (clause 27), and the chair's submission of annual accounts for audit (para 32(1)(b) of Schedule 1), joint preparation of reports undermines the AGW's clear personal accountability as Accounting Officer. The requirement for interim reports is also likely to be poor value for money. Annual reports should be sufficient to provide account of the AGW's and wider organisation's activities. Frequent set-piece interim reporting is unlikely to provide the value that would be provided by the ad hoc reporting to the Assembly of issues of concern by a supervisory board, as envisaged in paragraph C4.ii of annex C.
- A23. Clause 18(2) requires any scheme of delegation of the AGW to be approved by the WAO board. This is a significant constraint on the way the AGW exercises his or her functions. Among other things, it may prevent the AGW participating in the UK-wide National Fraud Initiative, which is explored further in paragraphs A37 to A41 below.
- A24. Clause 19 enables the WAO board to arrange with public bodies for the AGW to provide services to those bodies. But this clause does not require the AGW's agreement—the AGW may be outvoted by the rest of the board. The clause could lead to significant conflicts of interest that would undermine the AGW's audit independence. For example, the WAO board could arrange, despite the AGW's opposition, for the AGW to provide the payroll administration of a body that he or she audits. This would be a significant ethical issue and would conflict with international standards as it would involve the AGW auditing services that he has himself provided.
- A25. I also think the definition of "relevant authority" in clause 19 could be expanded so as to cover, for example, international development agencies that are not public bodies under UK law.
- A26. Clause 25 requires the organisation's annual plan to be agreed between the AGW and the WAO board. The AGW's work programme, including the studies that the AGW plans to undertake, is therefore subject to the WAO board's agreement. This infringes the AGW's

audit independence by fettering his judgement to select particular issues for examination. Clause 25 also requires that the resources to be allocated to the AGW's work programme are subject to the WAO board's agreement.

- A27. Related to clause 25, clause 26 requires the AGW's annual plan and funding to be subject to a procedure under which the AGW must submit to the board a statement of his or her work programme and an estimate of the maximum amount of resources required for it. While clause 26 seems to attempt to temper the WAO board's ability to interfere in the AGW's judgements about his work programme by saying that the WAO board may only reject a statement if it, or a part of it, is "unreasonable", this does not represent adequate protection of the AGW's audit independence. It still allows the WAO board to reject the AGW's judgement of what matters merit examination. It is also unsatisfactory in that it raises the prospect of dispute without providing a means of resolution.
- A28. The provision for rejection under clause 26 and the requirement for agreement under clause 25 both indicate that the only realistic means of resolving a difference of opinion on the work programme, other than compromise, which in the case of the AGW would mean compromising the independence of his or her judgement, is resignation of either the AGW or other members of the board. The suggestion that differences could be resolved in court, as put forward by the Welsh Government to PAC on 1 May 2012, is probably unworkable because of the innate conflict of interest that stems from AGW having to rely on legal advice contracted to the WAO, which is the body with which the AGW would be in dispute. At best, resort to court action is impractical and expensive.

**Clauses 29 to 37—miscellaneous and general provision**

- A29. Clause 29 enables the National Assembly to determine through Standing Orders how its functions under the Bill are to be exercised. I think this is appropriate as it helps remove the high degree of prescription of the Committee's work that was present in the draft Bill.
- A30. Clause 34 introduces Schedule 3, and para 5 of Schedule 3 provides for the transfer of staff from employment by the AGW to employment by the proposed WAO. These provisions would not be necessary if the proposed WAO were not to become the employer of staff, but if that is to proceed, it is important to note that they contain some problems that may lead to expensive disputes.
- A31. Para 5(2) of Sch 3 sets out that contracts of employment transfer from the AGW to the proposed WAO and will have effect as if originally made between the employee and the proposed WAO. It is arguable that this provides staff with some protection from adverse variations in their employment contracts, as under common law any changes in an employment contract must be agreed by both employee and employer. (But it falls short of the protection provided by Regulation 4(4) of TUPE.) At the same time, however, para 20 of Schedule 1 requires the proposed WAO to ensure that terms of employment are broadly in

line with those of the Welsh Government. This creates a tension if any terms of transferring staff are not broadly in line with Welsh Government terms, and the provisions may therefore set the new organisation on course for dispute with its staff.

- A32. Such tension may not be intended. The Welsh Government may intend para 20(5) of Schedule 1 to only apply to new starters, or be of the view that terms are already sufficiently in line to avoid any legal challenge. We have asked the Welsh Government for clarification of its intentions in this area. In any event, however, the Bill as drafted is not clear on this matter, and this may be a recipe for expensive legal dispute.
- A33. Another transfer issue is that the Bill does not provide the TUPE-like provisions that would be expected to give reassurance to staff. The Bill does provide the right for members of staff to object to their transfer (para 5(4) and (5) of Sch 3) as in the TUPE regulations. This reflects a fundamental right to choose whether to work for a particular employer, but it is one of little practical value to either employee or employer, as it adds nothing substantive to the right to resign. It does not help ensure that the organisation has adequate numbers of suitably qualified staff, and it does not help alleviate staff fears about job security. In the same vein, the Bill does not include TUPE-like provisions that are more reassuring to staff, such as those relating to protection of terms and conditions of employment, and protection from dismissal. This seems to be at odds with the Welsh Government's statement in para 242 of its consultation document on the draft bill of 15 March 2012 that "provision will be made so that the transfer of employment will be on no less favourable terms than would be the case if TUPE applied".
- A34. I think it would be helpful if the transfer provisions in Schedule 3 explicitly recognised that the transfer was the result of administrative reorganisation of public administrative authorities. This is important to provide clarity for pension administration purposes in dealings with both the Department for Work and Pensions and the pension scheme administrators.
- A35. Similarly, it would be helpful if para 5(2)(b) were changed so as to explicitly recognise previously transferred periods of employment. It is not clear from the existing provision that periods of employment of staff that transferred to AGW from the Audit Commission and NAO in 2005 are to be treated as continuous employment with the new WAO. This uncertainty is a cause for concern for such staff, who make up a majority of the current organisation.
- A36. Clause 35 introduces Schedule 4, minor and consequential amendments. While generally dealing with the consequential details of the main provisions outlined above, some of these are worth noting in particular.

- A37. Para 59 of Schedule 4 to the Bill amends section 64A(1) of the Public Audit (Wales) Act 2004 so as to remove provision for the AGW to arrange for persons to conduct data matching exercises on his behalf. (And paras 60 to 62 remove related provisions in Part 3A of the Public Audit (Wales) Act 2004, with the effect of preventing bodies providing information to a person acting on behalf of the AGW.) This is reinforced by the prohibition in clause 9(2) on the AGW doing anything that could become the responsibility of the WAO. My particular concern is that the practical effect of this may be to end the AGW's participation in the National Fraud Initiative (NFI), as such participation is only practicable if the AGW can engage the same service provider as that engaged by other UK audit agencies to undertake the data processing required on his or her behalf. The most recent NFI exercise resulted in the identification of £6 million of fraud and overpayments in Wales, so the loss of this participation would be most regrettable. The main NFI exercise is conducted once every two years.
- A38. Clause 18 of the Bill may overcome this as it enables the AGW to delegate his functions to contractors to the proposed corporate WAO, subject to approval of a scheme approved by the WAO. However, approval by the proposed WAO means that the AGW's participation in the NFI is subject to the agreement of the WAO board. In my view, this represents a serious potential infringement of the AGW's independence and a potential threat to the UK-wide approach to data matching to tackle fraud.
- A39. It is not clear, however, that AGW's delegation of his data matching functions to a contractor of the proposed corporate WAO would meet the requirements of the data matching legislation (Part 3A of the 2004 Act) and other legislation (including the Data Protection Act 1998). This lack of clarity has been confirmed to me by independent legal advice. Data matching is a very sensitive area that tends to attract legal challenge. The legislation therefore needs to be very clear so as to ensure that the work does not fall foul of data protection law, particularly where non-public sector bodies are involved.
- A40. As it stands, Part 3A of the 2004 Act is very specific in only permitting the information needed for matching to be disclosed to the AGW or a person acting on his behalf. Removing the provision for information to be disclosed to a person acting on behalf of the AGW, as proposed in the Bill, may be interpreted by a court as having precisely that effect. It is quite likely that citing the ability of the AGW to delegate his functions under clause 18 of the Bill would not be held to meet the specific requirements of Part 3A of the 2004 Act once the provision for AGW to arrange for data matching to be conducted on his behalf has been removed from that Act. Comparing the revised provisions of the 2004 Act against their equivalents in, for example, the Public Finance and Accountability (Scotland) Act 2000 would indicate that no provision of information to persons acting on behalf of the AGW is permitted. It could also be argued by anyone wanting to escape the scope of NFI that the service provider being contracted to the corporate WAO would be acting on behalf of the corporate WAO rather than the AGW.

- A41. A similar problem arises in terms of the results of data matching: the other participating audit bodies may not legally be able to share results with a contractor acting for the corporate WAO. It would be particularly awkward to try and address this problem through amendments aimed at substituting the corporate WAO for the AGW in the wider body of data matching legislation, as such amendments would be required to UK, Scottish and Northern Irish legislation. To avoid the loss of data matching in Wales, I would suggest the omission of paras 59 to 62 of Sch 4 to the Bill and omission or amendment of clause 9(2).

*Amendment to the Equality Act 2010*

- A42. Para 88 of Schedule 4 to the Bill amends Part 2 of Schedule 19 to the Equality Act 2010, which provides an example of how the Bill leads to an expansion of existing regulatory requirements because it creates an additional public body (the proposed WAO) alongside the AGW. The effect of para 88 is to add the proposed corporate WAO, in addition to the AGW, to the list of bodies designated as public authorities under the 2010 Act. This has the consequence of making both the corporate WAO and the AGW subject to the requirements of the Equality Act 2010 (Statutory Duties) (Wales) Regulations 2011. The practical effect of this is to require the corporate WAO and the AGW each to prepare and report progress on a strategic equality plan. They will also each have to engage with persons representing the interests of persons with protected characteristics regarding a range of duties, such as undertaking equality impact assessments of work plans. While it might be possible to share some of this work between the corporate WAO and the AGW, this amendment is likely to lead to an increase in the cost of arrangements needed to meet equality legislation.

*Amendment of the Freedom of Information Act 2000*

- A43. A similar effect arises from para 16 of Sch 4 to the Bill. This makes the proposed WAO a public body subject to the Freedom of Information Act. That in itself is appropriate, but it does effectively mean that Wales' public audit institution is subject to a double dose of regulation as both the AGW and the proposed WAO will need to prepare and maintain publication schemes, which, even if joint schemes can be agreed, will be an additional call on public money.
- A44. In terms of FOIA, the creation of a second public body within the same organisation with functions of holding information (clause 21(2)(d) and (e)) is also likely to lead to confusion as to which body holds particular requested information. For example, it would not be clear in the case of someone who sends a request to the WAO for a copy of a draft AGW study report (assuming AGW has prepared such a report but not provided it to Board colleagues) whether it would be correct for the WAO to respond to the requester to say that it does not hold the draft report. Practically, the draft is likely to be in the possession of WAO employees, but that alone would be unlikely to lead it being deemed to be held by the WAO. It might also be argued that the AGW as Chief Executive and board member of the WAO is part of the WAO, but this runs counter to the concept of the AGW being a separate public

authority under FOIA. Altogether, there is considerable scope for confusion and potentially expensive appeals to the Information Commissioner and Tribunal.

- A45. These amendments in respect of regulatory matters (paras 16 and 88 of Sch 4) raise wider issues regarding the increased burden of regulation that arises from moving from one public body to two. In addition to the specific amendments, other duplicate obligations will arise automatically from the creation of a corporate body alongside the AGW. For example, the proposed WAO will need to register with the Information Commissioner under the Data Protection Act 1998, but this will be alongside the AGW's own existing registration.
- A46. Another related issue is that the AGW will continue to be subject to regulatory calls on resources, such as the preparation of a strategic equality plan, but will not have his own resources to meet those statutory requirements. Under clause 18, the AGW will not be able to delegate the work necessary to achieve compliance with such requirements unless that delegation is approved by the corporate WAO. The AGW's compliance will therefore only be achieved if permitted by the proposed WAO board.

**The appropriateness of the powers in the Bill for Welsh Ministers to make subordinate legislation**

- A47. The three provisions for making subordinate legislation—clause 19(7) (approving bodies of accountants for the provision of services), clause 34(2) (supplementary etc provision) and clause 36(2) (commencement)—are all appropriate. However, as the AGW's quintessential purpose is reporting to the public and its representatives on government's use of resources, it would be preferable from the point of view of ensuring independence and audit effectiveness if these powers lay with the National Assembly rather than the Welsh Ministers.



**The financial implications of the Bill**

- B1. The impact assessment provided by the Welsh Government almost certainly significantly underestimates the cost of implementing the Bill. I should also note that the Welsh Government has not requested any comment from me regarding its costings.
- B2. The Welsh Government's impact assessment assumes that board members are paid £24,000 a year, and £30,000 in case of the Chair, yet they are to have the responsibility of running an organisation with a budget of some £24 million without a substantial executive presence (other than the AGW) on the board. I estimate that the fees would need to be somewhere in the region of 50 per cent higher than those identified by the Welsh Government (i.e. £600 and £750 a day for non-executive members and chair respectively). This would be in order to attract suitable candidates prepared to have a role that involves agreeing the organisation's annual plan, potentially rejecting the AGW's statement of work programme and resources, agreeing the delegation of the AGW's functions and having direct responsibility for employing staff, with all the legal responsibilities that those roles involve. There would also need to be payments in respect of National Insurance and travel and subsistence, which may add something of the order of a further 20 per cent to the base fees.
- B3. I also suspect that the Welsh Government's estimate of five days a month of input for such roles is on the low side. Also, the Board is likely to need to two co-opt independent members for its audit committee. Co-opted members will require remuneration, and I estimate that this will amount to some £10,000 including National Insurance and travel and subsistence.
- B4. The Welsh Government's estimate of the cost of support for the board of a corporate body (£29,000) is also likely to be too low. Such a board will need not only a secretariat providing administrative support, but it is also likely to require a substantial level of ongoing expert legal and technical advice on the proper exercise of its functions. I estimate that the secretariat employment costs will be in the region of £60,000 (including National Insurance etc) and that legal advice amounting to some £10,000 a year will be needed.
- B5. The Welsh Government has not included any amounts for the cost to the AGW of dealing with the legislative process in staff time and of obtaining external legal advice, which I estimate to be at least £30,000. No doubt it also has its own costs arising from pursuing the legislation, but I am not in a position to provide an estimate of such costs.
- B6. The Welsh Government has also not included any amounts for the cost of implementing the legislation. This will include WAO staff time and legal costs of dealing with the transfer scheme, revising the code of audit practice (required by clause 10), revising or producing new internal technical and HR policies for the new WAO, the creation of standing orders for the new board (required by para 25 of Sch 1), and other matters such as ensuring

compliance of both the AGW and the proposed WAO with equality legislation (see paragraph A42 above). I estimate that the cost of these items will be around £200,000.

- B7. There may also be some tax-related costs. Unlike the BRANA Act 2011, the Bill provides no protection from Corporation Tax and Capital Gains Tax liabilities arising from the transfer of assets. I have raised this issue with HMRC but do not yet have an indication of the likely approach to be taken by HMRC with the Bill as it stands, and I cannot therefore give an estimate of likely liability.
- B8. Similarly, if HMRC do not agree a dispensation with the proposed WAO in respect of the taxation of staff travel and subsistence expense payments incurred in respect of work for the AGW (rather than for WAO), then there will be an additional tax liability. Where one legal person pays expenses to its staff and those staff undertake work for another legal person, those expenses could become taxable in the hands of the recipients. In the absence of any agreed HMRC dispensation, under UK tax rules this would need to be met by staff personally, which would be out of line with Welsh Government terms and so a potential source of expensive dispute. Resolution might involve HMRC agreeing to WAO paying the tax for staff. I am hopeful that HMRC would agree to such a dispensation, and it is very difficult to identify the potential cost with any certainty, but it is possible that an additional cost to the WAO of up to £380,000 may arise.
- B9. Unless the tensions in the employment provisions of the Bill are satisfactorily addressed (see para 20 of the body of my letter and paras A14 and A15 of annex A), additional costs for staff time and legal services may be incurred due to the need to deal with disputes regarding terms. It is difficult to estimate the costs of such disputes with any certainty, but it would not be unrealistic to envisage two or three disputes arising, with each costing around £20,000 in staff time and legal costs.
- B10. The requirement for terms to be “broadly in line” with those of the Welsh Government may also incur significant additional costs if a Judge were to determine, contrary to my view, that existing terms are already broadly in line. In the absence of any such Judgment, however, I am not in a position to estimate the effect of the requirement to ensure terms are broadly in line with those of the Welsh Government.
- B11. Altogether, I estimate that the initial cost of the Bill as it stands lies between £180,000 and £350,000. I estimate that the ongoing cost lies between £200,000 and £650,000, with something nearer the lower figure more likely but not guaranteed (see summary table below). All increases in the cost base of the WAO will need to be financed by some combination of audit fee increases, efficiency savings and charges on the Welsh Consolidated Fund (via the annual estimate).

**Summary of cost estimates**

**One-off items**

| Item                                      | Lower Estimated Amount<br>£000 | Upper Estimated Amount<br>£000 |
|---|--------------------------------|--------------------------------|
| Cost of legislative process<br>(WAO only) | 30                             | 40                             |
| Implementation                            | 150                            | 250                            |
| Disputes                                  | 0                              | 60                             |
| <b>Total</b>                              | <b>180</b>                     | <b>350</b>                     |

**Recurring items**

| Item                                      | Lower Estimated Amount<br>£000 | Upper Estimated Amount<br>£000 |
|---|--------------------------------|--------------------------------|
| Board members' fees,<br>expenses and NI   | 155                            | 185                            |
| Co-opted members fees,<br>expenses and NI | 5                              | 15                             |
| Board secretariat                         | 40                             | 70                             |
| Travel and subsistence<br>taxation        | 0                              | 380                            |
| <b>Total</b>                              | <b>200</b>                     | <b>650</b>                     |

- B12. In addition, if the Bill prevents the AGW from participating in the National Fraud Initiative, as described in paragraphs A37 to A41 above, then this will have a cost to the taxpayer of lost savings amounting to some £3 million every year.
- B13. If the Bill were changed so as to provide a supervisory board, initial costs would be likely to be significantly lower, especially as no transfers of staff, assets or liabilities would be needed and the attendant risk of disputes would be removed. Similarly, on an ongoing basis, the cost is very likely to be at the lower estimated amount of £200,000, as board members' fees will not need to reflect business decision-making and employment responsibilities, and the

absence of a transfer of staff to the employment by the board will remove the risk of additional costs from a requirement to harmonise terms.

- B14. If the Bill were changed so as to provide a more fit for purpose corporate body (see annex D), then while ongoing costs would still be likely to be in the range of £200,000 and £650,000 a year, initial set up costs would be likely to be at the lower end of the range of £180,000 to £350,000. This would be because, as set out in annex D, the risk of staff-related disputes would be lower because the Board would not face a requirement to ensure WAO staff terms were in line with Welsh Government terms, and staff would be transferred under more TUPE-like provisions, reducing the scope for dispute. Other implementation matters, such as drafting or revising HR policies, may also be somewhat more straightforward and therefore incur less expense.

### Outline of the features of a supervisory board

- C1. I suggest that to help ensure their independence and overall suitability for carrying out a supervisory scrutiny role, the seven members of the board should be appointed by the National Assembly, as with the non-executive members under Schedule 1 of the Bill. Similarly, the National Assembly should determine the members' terms and conditions of office.
- C2. To maximise board objectivity and clarity of accountability of the AGW, I suggest that the AGW should not be a board member. At the same time, the range of membership may be enhanced so as to allow a greater range of stakeholder input.
- C3. I suggest that the board should have statutory powers to:
  - i. monitor and advise the AGW regarding the exercise of the AGW's functions (as in clause 17 of the Bill);
  - ii. require information and explanation from the AGW and other persons (AGW staff, suppliers and auditor) regarding the exercise of the AGW's functions;
  - iii. specify, in relation to the AGW's functions, the types of information that should be included in a report from the AGW to accompany the AGW's published annual accounts
  - iv. advise the National Assembly in support of its consideration of the AGW's estimate and annual report;
  - v. require the external auditor of the AGW to examine any matters of concern.
- C4. The board should also have duties to:
  - i. establish audit and remuneration committees;
  - ii. report to the National Assembly any matters of concern regarding the AGW.
- C5. I would also suggest that the National Assembly should be empowered to request the external auditor of the AGW to examine any matters of concern brought to the PAC's attention by the Board.
- C6. To maximise the Board's objectivity and the clarity of accountability of the AGW, the Board should not have executive functions, such as agreeing the AGW's annual plan, rejecting the AGW's work programme, charging and setting fees, and employing staff. Similarly, the board or its chair should not have functions of being substantively involved in preparing and laying estimates of income and expenses, laying the annual plan, submitting accounts for audit and

*Date:* 5 September 2012  
*Our ref:* HVT/1718/fgb  
*Page:* 22 of 24

preparing annual reports. All such functions should lie with the AGW. And in keeping with this, the AGW should be Accounting Officer for the organisation.

- C7. The board could be appropriately funded through its own separate estimate, or perhaps more pragmatically through a separate ring-fenced line within the annual estimate submitted by the AGW (but not determined by the AGW) to the National Assembly for its consideration.

**Outline of more workable corporate body arrangements**

- D1. I am firmly of the view that the AGW should be able to set his work programme, other than perhaps for ancillary work, independently. For this, there needs to be:
- i. removal of the clause 26 provision for the WAO board to reject the AGW's statement of work programme and resources;
  - ii. removal of the provision for the agreement of the annual plan by the WAO board (i.e. amend clause 25(1)) (but the requirement to take account of the advice of the board in setting the plan and estimate would remain).
- D2. The AGW should be able to delegate his statutory functions, other than perhaps in respect of ancillary work, to staff and contractors without needing to obtain the approval of the WAO board (i.e. clause 18(2) should be omitted).
- D3. Any arrangement for the AGW to provide services should, if the WAO board is to make such arrangements, be required to be made with the AGW's approval. (This could be achieved by amending clause 19.) This is necessary to prevent the AGW being subject to arrangements that compromise the AGW's independence, e.g. an agreement for the AGW to provide the payroll function for an audited body.
- D4. The WAO composition should be made more balanced so that there are some management members in addition to the AGW. This could be done by requiring at least two employee members, each to be nominated by the AGW. (In other words, para 1 of Sch 1 should be amended so as to change the board composition and para 14 of Sch 1 should be changed so that non-executives may only appoint employee members nominated by the AGW). However, the principle that non-executives will comprise the majority of the board must be maintained.
- D5. If the WAO board is to be the employee of staff, then for the sake of avoiding poor industrial relations and expensive litigation:
- i. the WAO should either not be subject to any "in line" requirements in respect of terms of employment, or else be required, in determining the terms of employment, to have regard to the desirability of keeping the terms broadly in line with those applying to staff of the Welsh Government (i.e. para 20(5) of Sch 1 to the Bill should be made much more like para 17 of Sch 2 to the BRANA act 2011);

*Date:* 5 September 2012  
*Our ref:* HVT/1718/fgb  
*Page:* 24 of 24

- ii. the staff transfer provisions (para 5 of Sch 3 to the Bill) should provide more TUPE-like protections that are reassuring for staff, especially in respect of protection of terms as under Regulation 4(4) of TUPE.
- D6. To protect AGW's participation in NFI, the amendment of Part 3A of the Public Audit (Wales) Act 2004 by paras 59 to 62 of Sch 4 to the Bill, which prevents AGW from arranging persons to conduct data matching exercises on his behalf, should be omitted. Clause 9(2) will also need to be omitted or amended so as not to contradict this.