Governance and Supreme Audit Institutions

Reflections from the UK National Audit Office

Introduction

1. Good governance lies at the heart of the mandate of Supreme Audit Institutions (SAIs) to hold public agencies to account for the way in which they use public resources and for recommending improvements. The key role played by SAIs in good governance is increasingly recognised by global institutions including the UN who see the International Organisation of Supreme Audit Institutions (INTOSAI) as a key partner in helping achieve the UN Sustainable Development Goals which were approved in October 2015. A key goal for the SAI community is Goal 16 and in particular 16.6 to ‘Develop effective, accountable and transparent institutions at all levels.’

2. If SAIs are to hold others accountable for their transparency, openness and good governance, they need to be beyond reproach and aspire to be exemplary public sector bodies. If they fail to live up to the high standards of stewardship they demand of others their reputation and credibility will suffer.

3. The INTOSAI community recognises this challenge and in the Congress in South Africa in 2010 ratified 12 principles describing the Values and Benefits of SAIs; principle 9 of which set out what SAIs need to do to ensure their own good governance.
**Principle 9: Ensuring good governance of SAIs:**

- SAIs should adopt and comply with good governance principles and report appropriately thereon.
- SAIs should periodically submit their performance to independent review, for example peer review.
- SAIs should have an appropriate organisational management and support structure that will give effect to good governance processes and support sound internal control and management practices.
- SAIs should assess organisational risk on a regular basis and supplement this with appropriately implemented and regularly monitored risk management initiatives, for example through an appropriately objective internal audit function.

**What do we mean by good governance?**

4 This paper looks at that principle and describes how the UK National Audit Office (NAO) seeks to comply with it (see Annex A for a diagrammatic representation of the NAO’s governance structures).

5 The paper aims to facilitate wider discussion in the SAI community about what good governance looks like in the context of managing modern SAIs. The paper describes how in the NAO good governance has evolved, and continues to evolve. It is context specific and what we are doing will not necessarily be applicable or have direct relevance to SAIs operating in radically different situations and working with differing audit models. However, what we hope this paper will help do is to stimulate debate and reflection – within individual SAIs in terms of whether there are aspects of good governance which their SAIs need to develop and with external partners in terms of what they might expect from SAIs. We know that our reputations are built on the rigour of the reports we publish and we have rigorous systems in place to assure the quality of our audit reports but equally if we are found wanting in the way we govern our organisations our reputations and credibility will suffer.

**Why is good governance important for SAIs?**

7 SAIs, through such vehicles as the 2007 INTOSAI Mexico declaration and more recently through a series of UN and Commonwealth Heads of Government resolutions, have stated very clearly that they need to be independent in order to carry out their external public audit role and to provide real benefits for citizens. To lay claim to that independence, they need to be able to demonstrate that they are capable of producing high-quality audits which add value and help improve the ways in which the public sector manages its resources. They also need to demonstrate that they can be trusted with managing their own resources efficiently and effectively and are able to show a sceptical public, media and parliament that they are doing so. It is important to remember too that good governance is not an end in itself but rather that it provides the basis for the effective use of the powers of SAIs.

8 The International Standards of Supreme Audit Institutions, ISSAI 12, on Values and Benefits states that SAIs need to practise what they preach. So, if SAIs are encouraging the organisations they audit to have sound systems in place for managing funds and achieving value for money, then SAIs need to ensure that they have effective internal audit, know the costs of their operations, can demonstrate their effectiveness and impacts, and listen regularly to feedback from their key external partners. Through the UN and the work of many leading international civil society organisations, there is a growing focus on openness and transparency – things which should be key maxims of SAIs – but equally a continual challenge for SAIs to demonstrate their compliance and leadership.

9 The push to demonstrate careful stewardship of a SAI’s resources has also become more necessary following the financial crisis of recent years. If across the public sector budgets are being cut and jobs lost, then it beholds SAIs to be constantly reviewing their own actions to make sure they are driving out waste and inefficiency and can justify their use of public funds.

**What is good governance in SAIs?**

**Ethical conduct**

10 This paper will focus particularly on how SAIs are managed and the ways in which best public sector principles of accountability, transparency, openness, economy, efficiency, effectiveness, and equity are operationalised. However, underpinning all this should be commitment by a SAI to a set of ethical values about what is the proper conduct of public business. SAIs need to not only be doing the right thing but also be seen to be doing the right thing. And these values need to be promoted by the most senior people in an organisation. If the SAI leadership do not practise the values then staff are unlikely to take the values seriously.
The importance of practising good governance and high standards of ethics are emphasised through training and development programmes at all levels of the business, including when new staff join the NAO but also at various stages through people’s careers as they are promoted.

Accountability

The NAO’s legislative framework

Well governed organisations have clearly articulated internal and external accountabilities, a common sense of purpose and clear structures for taking decisions and then following up to ensure these decisions are acted upon.

The NAO scrutinises public spending on behalf of Parliament. The audit and inspection rights are vested in the head of the Office, the Comptroller and Auditor General (C&AG). The staff of the NAO carry out these tasks on his behalf and both the C&AG and his staff are totally independent of government. They are not civil servants and do not report to any government minister.

The National Audit Act 1983 provided specific powers to allow the C&AG to report to Parliament at his own discretion on the value for money achieved by government departments. The Act also established the Public Accounts Commission (TPAC) to oversee the work of the NAO. TPAC receives the NAO’s Annual Report and Accounts as well as the Corporate Strategy and Business Plan, approves the NAO’s budget and appoints the NAO’s external auditor. In 2007, TPAC commissioned a review of corporate governance at the NAO to ensure that these conformed to best practice. As a result the Budget Responsibility and National Audit Act 2011 (BRANA) established the NAO as a corporate body led by a board.

In scrutinising the NAO’s performance and reviewing its budget request TPAC seeks additional advice and input – including from HM Treasury, and the UK Ministry of Finance. While the NAO does not have to follow this advice it does seek to be mindful of the prevailing state of the overall public finances. The results of this hearing are published on the parliamentary website: www.parliament.uk/business/committees/committees-a-z/other-committees/public-accounts-commission/

TPAC appoints a private sector firm to audit the NAO’s Annual Accounts. The audit opinion is attached to the Annual Report and Account and the audit findings discussed with the board’s Audit committee, and where appropriate the board. The NAO’s external auditor is also tasked by TPAC to carry out a value-for-money audit of an aspect of the NAO’s work each year. The subjects for these reviews are chosen by the NAO Board. In recent years, the external auditor has been asked to examine the NAO’s management information; the Transformation Programme; and the NAO’s Human Resources processes.

The C&AG is an independent Officer of the House of Commons appointed for a fixed ten year term by Her Majesty the Queen upon an address to Parliament by the Prime Minister and seconded by the Chair of the Committee of Public Accounts (PAC) – by convention a senior figure from the leading opposition party. The C&AG may be removed only by Her Majesty the Queen on an address of both Houses of Parliament. This fully ensures his independence from the executive branch of government. There are also restrictions on the appointment of a former C&AG to certain roles for two years after the end of their employment. The C&AG’s pay is determined at the time of his appointment. It is agreed by the Prime Minister and the Chair of the PAC. It may include a pension, but no element of it is to be performance based. It is paid from the Consolidated Fund.
The non-executive Chair of the board is appointed by the Queen, under a similar process to that used to appoint the C&AG. The Chair and other non-executive members serve for a fixed term up to three years, renewable for one further term. TPAC is responsible for the appointment of the NAO’s non-executive board members (excluding the Chair) on the recommendation of the Chair. The executive board members are appointed annually by the non-executive board members upon the recommendation of the C&AG.

Role of the board

The NAO Board is comprised of nine members: five non-executives and four executive members (including the C&AG). They have collective responsibility for agreeing the NAO strategy and targets, approving the budget requests to parliament, and monitoring progress against that strategy. In addition, the board supports and advises the C&AG, who retains his independence in terms of his statutory functions and his audit judgements, in the fulfilment of his role. The relationship between the board and the C&AG is set out in an agreed Code of Practice which is published on the NAO website. To enhance their understanding of the organisation, the non-executive members of the board, hold regular events when staff can make appointments to discuss their work with board members.

The C&AG’s professional independence is core to this process. The decision as to what to audit, how to audit, what audit opinion to issue, and how and when to report are his. However, the board’s role is to make sure that he uses the resources at his disposal well and to approve all non-statutory activities. A key aspect of the effectiveness of the board is its ability to offer constructive challenge to the C&AG and to hold him to account for his management of the NAO’s resources. This challenge is particularly important when public resources are under pressure and there may be a need for the NAO to make tough budgetary decisions.

The board is also responsible for the organisational risk assessment. For each of the business risks identified by the board, the NAO has set a risk tolerance and put in place systems for managing these risks. The systems are not designed to eliminate all risk but to strike a balance between control, cost of control and appropriate risk taking. For example, the NAO’s tolerance of risk in areas of professional audit judgement, regularity and propriety is low. In other areas, for example, change management, we are prepared to accept more risk in order to take advantage of opportunities to pursue our objectives. Six areas of operational and strategic risk are reviewed monthly and included as a standing item on the board’s meeting agenda.

The board voluntarily applies the provisions of the UK government code of good practice for corporate governance in central government – reporting against it each year highlighting those areas where the NAO’s statutory position requires alternative arrangements, and can be viewed here. The C&AG, as the NAO’s accounting officer, produces an annual governance statement as part of the Annual Report and Accounts. This statement describes the controls operating in the NAO and the work of the board and provides assurance that he is satisfied that there are no significant weaknesses in the NAO’s systems of internal controls that affect the achievement of the NAO’s key policies, aims and objectives.

The board has created the following committees. Both committees draw their membership from the non-executive members of the board:

- an audit committee to agree the programme of internal audits, receive the reports from internal and external audit, respond to these audits and ensure that agreed recommendations are implemented; review internal controls, review risk management processes, review governance arrangements of the NAO, and review the quality and reliability of financial reporting; and
- a remuneration and nominations committee which is responsible for the remuneration of the three executive members of the board other than the C&AG, advising the C&AG and Chair on succession planning and appointments to the Leadership Team and board, and overseeing major changes in NAO employee benefits.

One of the keys to effective governance is the provision of timely and accurate information. The board and Leadership Team (and their committees) receive dedicated secretariat support from the NAO’s governance team. This governance team:

- supports the administration of the governance structures;
- ensures strategic alignment between the governance structures and the rest of the NAO;
- provides an interface between the board and the NAO; and
- provides independent advice to non-executives.

The performance of the board and its committees against board objectives is assessed on an annual basis, supported by the governance team. In exercising its stewardship the board is mindful of developments across the public sector and in particular best practices in managing public money. During the review process it is important that the board addresses in as open and honest a way as possible how it has contributed to the success of the office, how it has added value to the work, whether it is working effectively as a body able to challenge constructively the C&AG and the senior management team, and whether it has the right sets of skills as the work of the NAO shifts and develops. For example, as the NAO has started to play a more significant role in looking at regional and local issues, it has been necessary to recruit a board member with this expertise.

Managing the NAO

The NAO has a three year strategy and an annual business plan. While these planning activities are participative, with staff actively involved in identification of future audit work and other NAO activities, once the plans are approved by the board and the budgets allocated, then staff are expected to implement these agreed plans and their performance is monitored against agreed deliveries and agreed budgets. The NAO’s leadership team sets clear expectations of their own accountability and that of their directors through annually agreed objectives and close monitoring.
30 To manage the day by day operations, the NAO’s leadership team – comprising the C&AG, the executive members of the board, plus three other senior managers – has established three management committees:

- audit Practice Quality Committee to review the comprehensiveness, reliability and integrity of the framework supporting the quality of the NAO’s audit work;
- operational Capability Committee to support the leadership team in delivering appropriate resources and support the NAO in achieving its business objectives; and
- change Management and Assurance Committee to provide oversight of the change portfolio and advise the leadership team on progress, risks and priorities.

Role of internal audit

31 Where there are corporate policies, once these are agreed, staff are expected to comply and failure to do so can result in disciplinary procedures being initiated. One of the roles of internal audit is to test the extent of staff compliance with agreed policies. The C&AG’s annual review of the effectiveness of the system of internal control is informed by the work of the Director of Internal Audit and Assurance (DIAA), the Executive Leaders within the NAO who have responsibility for the development and maintenance of the internal control framework, comments made by the external auditors in their management letter and other reports.

32 The Director of Internal Audit and Assurance has regular progress meetings with the C&AG which include reporting on progress against the internal audit plan and highlighting emerging issues. The DIAA presents his Internal Audit Annual Report which contains commentary on the work completed, each assignment and its opinion concluding with an overall annual opinion. The Report’s annual opinion is in a format consistent with internal control framework, comments made by the external auditors in their management letter and other reports.

33 Throughout the year the DIAA reports progress to each of the five Audit Committee meetings including detailed assignment reports, and at the year end provides the Committee with an Internal Audit Annual Report. In February of each year he presents his refreshed Internal Audit Strategic Plan and Operational plan for the year ahead. The DIAA is responsible for quality control and his performance is monitored annually by the Audit Committee. In support of this he conducts an annual self-assessment of compliance with the Public Sector Internal Audit Standards and monitors the impact of internal audit through satisfaction surveys with both auditees after each assignment and periodically with the non-executives. The results of the opinion work and quality assessments contribute to the Audit Committee’s own annual report to the board.

34 Delegations are in place so that it is clear to managers across the NAO what levels of expenditure they can approve – with the highest levels of expenditure needing to be referred to the board for approval.

Transparency

35 The NAO operates on the principle that as much as possible of its work will be placed in the public domain. The NAO website includes all NAO reports and other publications, the forward programme of audits and a range of other materials which it is hoped will interest citizens, public servants and parliamentarians. The website also contains full information on the NAO’s mandate, responsibilities, mission and strategy. Increasingly also the NAO uses a wide range of social media to provide alerts to subscribers when new work is produced. The NAO adopts a cooperative and helpful attitude when working with the media, while at the same time working to promote and protect the organisation.

36 The NAO’s Annual Report and Accounts contains a narrative section showing what we have achieved in the preceding year and the annual accounts with the audit opinion provided by our external audit. The Report also contains evidence of feedback from clients and key stakeholders, lists key financial impacts and client or partner feedback. It also shows the total remuneration packages of senior staff including the value of their pensions.

37 The NAO makes a voluntary disclosure of all travel and subsistence claimed by board and leadership team members, and details of all hospitality provided and received and these are also shown on the external website. A list of payments to suppliers where the payment is £500 or over is published on our website and we publish sustainability data in our Annual Report and Accounts.

38 The NAO has its own whistleblowing policy to guide staff in raising public interest concerns regarding the NAO’s own operations; there are separate policies for dealing with other concerns and personal grievances. Concerns can be raised with the Directors of Human Resource or Internal Audit and Assurance, or the NAO’s head of Policy and Legal. Alternatively, should the concerns be of a particularly serious nature, or concern the C&AG, staff can contact the NAO’s Senior Independent Board Member who will investigate. Staff are encouraged to raise concerns in person, but the policy does allow for concerns to be raised anonymously.

The policy sets out the process by which all concerns will be investigated, and provides staff with details of organisations outside the NAO who can provide support and advice.
39. Borrowing from good practice in the private sector, the NAO produces an annual transparency report which provides considerable detail on how the NAO maintains quality.

Openness

40. Internally the NAO uses a wide range of strategies so that staff understand key decisions being made by the board and senior managers. Board minutes are published externally, and a note of the meetings of the board and the executive leadership team are published to all staff. Senior management use a wide variety of formal and informal, written and oral methods to reach staff and encourage staff participation and feedback.

41. Externally the NAO maintains close links with all key stakeholders. The C&AG and other members of the leadership team meet regularly with the heads of public services – both on a one to one basis and as a whole. Parliament, especially the Committee of Public Accounts, is consulted on our forward programme and invited to help us shape up and identify future audit activities. Citizens and civil society organisations are involved in our studies – at times as members of study reference panels and more regularly as participants in focus groups or by responding to questionnaires. All key stakeholder groups are regularly surveyed to assess levels of satisfaction with the work of the NAO.

42. Members of the public write to the NAO with their concerns and these are dealt with promptly and fully – with some of these concerns finding their way into full NAO VFM or performance audit reports. We are governed by the UK Freedom of Information Act (2000) and respond constructively to all requests for information. In doing so we seek to be transparent and our default position is to disclose the information we have except where the information is covered by one of the exemptions. The exemptions include personal information under the Data Protection Act and information which if disclosed would undermine the efficient operation of the audit process (under section 33 of the FOI Act) although this may be outweighed by the public interest in disclosing the information.

43. The NAO aims to reinforce its reputation as an independent and impartial parliamentary body by working closely with the media, and highlighting how the NAO scrutinises public spending for Parliament.

44. Openness needs of course to be tempered with a commitment to information security. NAO has privileged and wide-ranging access to data, including personal and other sensitive data, to enable it to undertake its audit work. The NAO has a duty to respect this privileged access and to ensure that the data entrusted to it is safeguarded properly. The UK Cabinet Office’s Security Policy Framework (SPF) sets out the measures which UK government bodies should have in place when handling personal and sensitive data, and the NAO has opted to comply with the SPF. The measures which the NAO have in place include: encrypted laptops and memory sticks; a clear desk policy whereby all IT equipment and papers are locked away at the end of the working day; a network of Information Asset Owners who are responsible for ensuring that the NAO’s data security policies and procedures are followed; and annual staff training covering data security. We publish a Statement of information risk acknowledging our duty to respect our privileged and wide ranging access to data and information in our Annual Report and Accounts.

Economy

45. The NAO is clear that it needs to be parsimonious with public resources. Staff are paid well – with salaries slightly higher than prevailing rates in government recognising that their skills are in high demand and if we get the pay rates wrong we will lose too many staff. Starting salaries for graduates are comparable with those paid by the private sector and as staff progress we also consider the market rate for qualified accountants. At the same time we are mindful that working in the NAO brings non financial benefits – not least of which is the capacity to play a constructive role in improving the management of government.

46. Staff are expected to recognise the privileged position they hold and to be careful to ensure that all expenditure is carefully scrutinised and reasonable. NAO staff, including the C&AG and other members of the leadership team, are expected to travel economy class on planes and trains, and expense claims for hotels and other costs are in line with government-wide figures agreed with HM Revenue & Customs.

47. We have also sought to increase our income generating capabilities. By moving to open plan seating and doing away with offices, with even the C&AG not having his own office, we have released nearly a third of our building and now rent that out to other clients. Even on evenings and weekends we have found ways of raising revenue by renting out training rooms and other parts of our main office – of course ensuring that the core NAO parts of the building are secure and confidential information safe.

48. Expenditure should be targeted at what is needed to do the job and not wasted on luxuries which others might challenge as unnecessary and out of step with community expectations. Staff are expected to be familiar with NAO internal policies on hospitality and on travel.

49. Hospitality, for example, is kept to a minimum. Not only are staff not meant to receive hospitality but increasingly also the NAO is unable to offer hospitality to external visitors. If staff receive hospitality or other gifts these need to be declared on a public register and all but the smallest gifts handed over to become the property of the NAO.

50. Similarly, the NAO travel policy seeks to ensure that expenditure is carefully managed. For example, NAO participation in international meetings is carefully managed. For most meetings the NAO will only send one person unless the NAO is chairing a meeting in which case the NAO may consider sending two people and economy flights are the norm – even on long haul flights. Increasingly the default position is to use teleconferencing and videoconferencing.
Efficiency

51 The NAO has an effective system for costing all audits and other jobs so staff are allocated budgets for individual audits and held accountable for managing these jobs against their budgets. There is constant downward pressure on budgets and attempts to deliver more with less. Over the past five years:
- we have reduced the overall costs of the NAO by 23% in real terms since 2010-11, despite taking on new responsibilities for local government audit,
- the average cost of a performance audit has fallen from £233,000 in 2010-11 to £178,000 in 2014-15, and eight in ten are produced in nine months or less; and
- we continue to meet our target to ensure that our back-office business support services account for no more than 20% of our costs.

52 These efficiency issues are being implemented with no evident reduction in the effective coverage of UK public expenditure and revenue, nor evident reduction in the quality of our work or the satisfaction of clients.

Effectiveness

53 The NAO has a strong focus on effectiveness. At the highest level, the organisation seeks to generate savings of well over ten times its overall budget – and these claims are independently verified by the NAO’s external auditor. However, the NAO takes a broader approach to effectiveness – closely following up on audit recommendations which are recorded in both our own reports and the reports produced by the Committee of Public Accounts.

54 We also ensure that our work is subjected to external peer review. The Audit Quality Review team of the Financial Review Committee, a joint monitoring unit of the major professional accounting bodies, annually reviews our whole-office procedures and a selection of audit files. In addition, the NAO’s compliance and quality unit seeks annual feedback from all audited bodies on the audit’s performance.

55 For 20 years we have used external specialists to review VfM reports. In 2013-14, a sample of our reports was reviewed by independent experts from Oxford University, Said Business School (trading as ISIS innovation), Risk Solutions/Cass Business School and RAND Europe. The results of these reviews are then disseminated across the NAO and training provided to staff where generic issues are identified.

Equity

56 Increasingly good governance also involves ensuring that an organisation can demonstrate in all of its processes that it is seeking to treat people fairly and equally.

57 The NAO recognises that to be a professional organisation it needs to recruit high-calibre staff and reward them appropriately. The processes used to recruit staff at all levels are transparent and open – even the post of Comptroller and Auditor General, Chairman of the Board and non-executive member of the board are all filled after an open recruitment process. Staff are recruited to the NAO via public recruitment processes and then put through a rigorous process of interview and assessments. Once in the organisation they serve a probationary period, and if they perform, are offered a permanent position. Promotions are advertised internally, and at times externally, and again a transparent and fair process operates. Promotion is based on merit not longevity and there are many strategies in place to ensure that the process is open to all regardless of gender, sexual orientation, ethnicity, or religion.

58 Bullying or harassment in the workplace is taken seriously with training programmes, coaching and mentoring to develop an inclusive approach to management which recognises the dignity of all members of staff. At the same time, the NAO is a performance focused organisation and staff who fail to perform after receiving advice and support are asked to leave.

Do we get it right?

59 Good governance is not an end state but something all organisations need to keep under close scrutiny. There are always ways we can improve but we do think we have moved a long way in recent years.

60 There are no doubt other ways to deliver good governance in SAIs. This paper has shown how the NAO seeks to achieve this. Other SAIs, particularly those operating as Courts of Audit, will have developed other approaches and other ways of responding to the challenge of being leading public sector organisations.

61 We hope this paper will be both a challenge to the SAI sector globally but also that it will elicit other responses so that from each other’s experiences we can all learn to govern our organisations better.

David Goldsworthy
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Annex A

Process map of NAO governance arrangements

Parliament/TPAC
1. Her Majesty the Queen is responsible for the appointment of the C&AG and NAO chair for fixed terms upon addresses to Parliament by the Prime Minster seconded by the Chair of the Committee of Public Accounts. The C&AG may be removed only by Her Majesty the Queen upon an address of both Houses of Parliament.
2. TPAC is responsible for approving NAO’s strategy and budget and the appointments of non-executive board members and external auditors.

Internal audit
Responsible for annual report of governance, risk and controls arrangements.¹

NAO stakeholders
Published information includes NAO reports, the Annual Report and Accounts and Board minutes and voluntary disclosures of T&S expenses, hospitality and payments to suppliers.

Comptroller and Auditor General
The C&AG is an independent officer of the House of Commons.

Limitation team
Responsible for executive management and governance of operational delivery of the NAO.

Leadership team
Responsible for executive management and governance of operational delivery of the NAO.

Remuneration and Nominations Committee
Responsible for the remuneration of executive members of the Board and providing advice to the C&AG and NAO chair on succession planning for senior appointments.

Audit Committee
Responsible for overseeing governance framework and reviewing the quality and reliability of financial reporting.

External audit
Responsible for carrying out financial and VFM audits of the NAO.

Change Management and Assurance Committee
Responsible for oversight of the change portfolio.

Financial Review Committee and other independent experts
Responsible for annual review of procedures and financial audit files and VFM reports.

Audit Practice Quality Committee
Responsible for reviewing the framework supporting the quality of NAO audit work.

National Audit Office
1. Code of conduct.
2. Professional and ethical standards and whistleblowing procedures.
3. Staff independent of government.
4. Follow up on own and PAC recommendations.
5. Survey stakeholders.

Operational Capability Committee
Responsible for supporting the delivery of appropriate resources.

Goverance team
Responsible for providing timely and accurate information for decision making.

Note
¹ Internal Audit also reports to the National Audit Office Board.