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ACCOUNTABILITY

This letter draws attention to the revised chapter 3 of *Managing Public Money* and to a new draft annex 3.1 on governance statements which will in time replace the existing annex 4.15 on statements on internal control. Both are attached.

There are several areas in which the revised chapter 3 strengthens the duties of accounting officers. The revised text takes effect immediately.

The draft new annex is intended to take effect in spring 2012, so that it will bear on the drafting of annual reports and accounts for the financial year 2011-12. Public sector organisations are free to adopt this standard for the reports on the financial year 2010-11 if they choose.

People working in all public sector organisations governed by *Managing Public Money* should be made aware of the contents of this letter.

If you have enquiries about this letter (including comments on the draft annex 3.1), please contact Jim Duncan (Jim.Duncan@hmtreasury.gsi.gov.uk Tel: 020 7270 5715).

2. Perhaps the most important point to make is that the basic concept of the accounting officer is not changing. He or she remains the principal official in a public sector organisation charged with making decisions about its use of public resources.

3. The text of *Managing Public Money* on the Treasury's website will soon include the updated version of chapter 3 and annex 3.1, the latter clearly identified as a draft.



The main changes

4. The most significant changes in chapter 3 were discussed with the PAC at a hearing on 19 January 2011. The PAC has now endorsed them in principle. See: <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/740/74002.htm>

5. Chapter 3 now requires accounting officers to consider whether proposed policies or activities are **feasible** when considering whether to seek a **ministerial direction** (see section 3.4 and box 3.2). Often this issue will be bound up with assessment of value for money. But the two concepts are distinct. They do not always coincide.

6. In recognition of an issue the PAC has recently highlighted, the revised text brings out the long standing duty to ensure that decisions with resources implications are **affordable and sustainable** (see box 3.1 and the new third bullet of para 3.3). This always means respecting the agreed budgets. For organisations where commitments can stretch beyond the public expenditure planning horizon, it also means making proportionate assessment of other likely demands on the organisation's resources. Accounting officers should not lightly assume that space will be made to fit long term demands.

7. Chapter 3 now also assumes that **ministerial directions will be published**. The norm will be to publish no later than the report and accounts. There is no barrier to earlier publication. This new standard should be balanced against any conflicting concerns about confidentiality, sensitivity or other aspects of the broader public interest.

Other issues

8. Picking up recent departmental experience, the criteria for appointing **other accounting officers** (section 3.2) are now slightly broader. They allow scope for principal accounting officers to determine a significant area of the business of their department for which an additional accounting officer may take responsibility. This is a matter at the principal accounting officer's discretion.

9. In the light of experience, the revised text highlights an aspect of departmental oversight of **arm's length bodies** (ALBs) (see section 3.8). In the event of serious failure at an ALB, the principal accounting officer should be able to arrange for the governance of the ALB to be adjusted, even replaced, if that is necessary to bring about required improvements. The mechanism chosen is not defined. It may be wise to alert leaders of ALBs to this responsibility on appointment.



The governance statement

10. The governance statement, to be introduced from April 2012, is not really new. It simply unites the statement on internal control and the requirement to publish a comprehensive explanation of how the internal governance of a department should work. It is good practice for ALBs to follow the same approach.

11. These two statements are being brought together because they share so much common ground. There is no set template for drawing up the new statement. It is up to each accounting officer to decide the coverage and emphasis for the organisation he or she leads, drawing on recent experience. The statement should also take account of the board's advice on the important matters affecting the organisation and its stance on risk management, investment strategy and other corporate preferences.

Managing Public Money

12. With the passage of time, some aspects of *Managing Public Money* are becoming out of date. A fully refreshed text will be issued in the next few months.

Yours sincerely,

Paula Diggle

Paula Diggle
Treasury Officer of Accounts



3

ACCOUNTING OFFICERS

This chapter sets out the personal responsibilities of all Accounting Officers in central government. Essentially accounting officers must be able to assure parliament and the public of high standards of probity in the management of public funds. This chapter is drawn to the attention of all accounting officers when they are appointed.

3.1 Role of the accounting officer

3.1.1 Each organisation in central government - department, agency, trading fund, NHS body, NDPB or arm's length body - must have an accounting officer (AO). This person is usually its senior official. The accounting officer in an organisation should be supported by a board structured in line with the *Corporate Governance Code*.

3.1.2 Formally the accounting officer in a public sector organisation is someone whom parliament may call to account for the stewardship of the resources within its control. The standards the accounting officer is expected to deliver are summarised in box 3.1. The equivalent senior business managers of other public sector organisations are expected to deliver equivalent standards.

3.2 Appointment of accounting officers

3.2.1 The Treasury appoints the permanent head of each central government department to be its accounting officer. Where there are several accounting officers in a department, the permanent head is the principal accounting officer.

3.2.2 Within departments, the Treasury also appoints the chief executive of each trading fund as its accounting officer; and may also appoint additional accounting officers with responsibility a defined part of the department's business.

3.2.3 In turn the principal accounting officer of each department normally appoints the permanent heads:

- of its executive agencies, as agency accounting officers for their agencies; and
- of other ALBs (including all NDPB), as accounting officers for these bodies; and
- at his or her discretion, other accounting officers for defined part(s) of the department's business.

3.3 Special responsibilities of accounting officers

3.3.1 It is important that each accounting officer takes personal responsibility for ensuring that the organisation he or she manages delivers the standards in box 1.1. In particular, the accounting officer must personally sign:

- the accounts
- the annual report
- the governance statement;

and, having been satisfied that they have been properly prepared to reflect the business of the organisation, must personally approve:

- voted budget limits; and
- the associated Estimates Memorandum.

box 3.1: standards expected of the accounting officer's organisation

Acting within the authority of the minister(s) to whom he or she is responsible, the accounting officer should ensure that the organisation, and any ALB it sponsors, operates effectively and to a high standard of probity. The organisation should:

governance

- have a governance structure which transmits, delegates, implements and enforces decisions
- have trustworthy internal controls to safeguard, channel and record resources as intended
- operate with propriety and regularity in all its transactions
- treat its customers and business counterparties fairly and honestly
- offer appropriate redress for failure to meet agreed customer standards
- give timely, transparent and realistic accounts of its business and decisions, underpinning public confidence;

decision-making

- support its ministers with clear, well reasoned, timely and impartial advice
- make all its decisions in line with the strategy, aims and objectives of the organisation set by ministers and/or in legislation
- manage its staff fairly, with inclusive policies designed to promote equality and integrate diversity
- impose no more than proportionate and defensible burdens on business;

financial management

- use its resources efficiently, economically and effectively, avoiding waste and extravagance
- operate within the agreed limits on use of public resource
- plan to use its resources on an affordable and sustainable path
- carry out procurement and project appraisal objectively and fairly, using cost benefit analysis and generally seeking good value for the public sector as a whole
- use management information systems to secure assurance about value for money and the quality of delivery and so make timely adjustments
- avoid overdefining detail and imposing undue compliance costs, either internally or on its customers and stakeholders
- have practical documented arrangements for controlling or working in partnership with other organisations, as appropriate
- use internal and external audit to improve its internal controls and performance.

3.3.2 The accounting officer of a corporate arm's length body should arrange for a board member to sign the accounts as well as signing them himself or herself, if (unusually) he or she is not a member of the board.

3.3.3 There are several other areas where accounting officers should take personal responsibility:

- *regularity and propriety* (see box 2.4), including seeking Treasury approval for any expenditure outside the normal delegations or outside the subheads of Estimates;

- selection and *appraisal* of programmes and projects: using the Treasury's *Green Book* to evaluate alternatives, and good quality project and programme management techniques, such as PRINCE2, to track and where necessary adjust progress;
- *affordability and sustainability*: respecting agreed budgets and avoiding unaffordable longer term commitments, taking a proportionate view about other demands for resources;
- *value for money*: ensuring that the organisation's procurement, projects and processes are systematically evaluated and assessed to provide confidence about suitability, effectiveness, prudence, quality, good value and avoidance of error and other waste, judged for the public sector as a whole, not just for the accounting officer's organisation;
- management of *opportunity and risk* to achieve the right balance commensurate with the institution's business and risk appetite;
- *learning from experience*, both using internal feedback, and from right across the public sector; and
- accounting accurately for the organisation's *financial position* and *transactions*: to ensure that the government published financial information is transparent and up to date; and that the organisation's efficiency in the use of resources is tracked and recorded.

3.3.4 In the case of principal accounting officers, these responsibilities apply to the business of the whole departmental group.

3.4 Advice to ministers

3.4.1 Each departmental accounting officer should take care to bring to the attention of the minister(s) to whom he or she is responsible any conflict between the minister's instructions and his or her duties. The accounting officer cannot simply accept the minister's aims or policy without examination. There is no set form for registering objections, though the accounting officer should be specific about their nature. The acid test is whether the accounting officer could justify the proposed activity if asked to defend it.

3.4.2 If, despite the accounting officer's advice, the minister decides to continue with a course the accounting officer has advised against, the accounting officer should ask for a formal direction to proceed. If this is initially given orally, it should be confirmed in writing quickly. Examples of where this procedure is appropriate are in box 3.2.

box 3.2: when accounting officers should seek a direction

- **Regularity**: if a proposal is outside the legal powers, Parliamentary consents, or Treasury delegations; or incompatible with the agreed spending budgets.
- **Propriety**: if a proposal would breach Parliamentary control procedures or expectations.
- **Value for money**: if an alternative proposal, or doing nothing, would deliver better value, eg a cheaper, higher quality or more effective outcome.
- **Feasibility**: where there is a serious doubt about whether the proposal can be implemented accurately, sustainably, or to the intended timetable.

3.4.3 Directions of this kind are rare. It is good practice for accounting officers to discuss the matter with the Treasury if time permits. The ultimate judgement in each case must lie with the accounting officer personally.

3.4.4 When a direction is made, the accounting officer should:

- copy the relevant papers to the C&AG and the TOA promptly. The C&AG will normally draw the matter to the attention of the PAC, who will attach no blame to the accounting officer;
- follow the minister's direction without further ado;
- if asked, explain the minister's course of action. This respects ministers' rights to frank advice, while protecting the quality of internal debate;
- arrange for the existence of the direction to be published, no later than in the report and accounts, unless the matter must be kept confidential.

3.5 Public Accounts Committee

3.5.1 The PAC may hold public hearings on the accounts of central government organisations laid in Parliament (see section 1.6). In practice most PAC hearings focus on NAO value for money studies. NAO seeks to agree the texts of these reports with the accounting officer(s) concerned so there is a clear undisputed evidence base for PAC scrutiny.

3.5.2 When a hearing is scheduled, the PAC normally invites the accounting officer(s) of the relevant institution(s) to attend as witness(es). An accounting officer may be accompanied by appropriate officials. Where it is appropriate, and the PAC agrees, an accounting officer may send a substitute. In answering questions, the accounting officer should take responsibility for the organisation's business, even if it was delegated or if the events in question happened before he or she was appointed accounting officer. The PAC may also invite other witnesses who may not be public servants to give insight into the background of the subject in hand.

3.5.3 The PAC expects witnesses to give clear, accurate and complete evidence. If evidence is sensitive, witnesses may ask to give it in private. Witnesses may offer supplementary notes if the information sought is not to hand at the hearing. Any such notes should be provided within one week. If the evidence might take longer to prepare, witnesses may seek an extension. They should do so without delay.

3.5.4 The TOA (or an alternate) attends all PAC hearings. This enables the PAC to explore any more general issues arising out of the hearing.

3.6 When the accounting officer is not available

3.6.1 Each public sector organisation must have an accounting officer available for advice or decision as necessary at short notice.

3.6.2 When the accounting officer is absent and cannot readily be contacted, another senior official should deputise. If a significant absence is planned, the accounting officer may invite the Treasury (or the sponsor department, as the case may be) to appoint a temporary acting accounting officer.

3.7 Conflicts of interest

3.7.1 If an accounting officer faces an actual or potential conflict of interest, it is essential to find a way of dealing with it. There must be no doubt that the accounting officer meets the standards described in box 3.1 without divided loyalties. Possible ways of managing this issue include:

- for a significant but temporary conflict, inviting the Treasury (or sponsor department, as the case may be) to appoint an interim accounting officer for the period of the conflict of interest;
- for a minor conflict, declaring the conflict and arranging for someone other than the accounting officer to make decisions on the issue(s) in question; or
- for serious and lasting conflicts, resignation.

3.8 Arm's length bodies

3.8.1 The responsibilities of accounting officers in departments and in arm's length bodies (ALBs) are essentially very similar. But accounting officers in ALBs must also take account of their special responsibilities and powers. In particular, they must respect the legislation (or equivalent) establishing the organisation and the terms of the framework document agreed with the sponsor department. The relationship between sponsor departments and their ALBs is discussed further in chapter 7.

3.8.2 The accounting officer of a sponsor department should make arrangements to satisfy himself or herself that the ALB has systems adequate to meet the standards in box 3.1. Similarly, the accounting officer of an ALB with a subsidiary should have some meaningful oversight of the subsidiary. It is not acceptable to establish ALBs, or subsidiaries to ALBs, in order to avoid or weaken parliamentary scrutiny.

3.8.3 The framework document (or equivalent) agreed between an ALB and its sponsor always provides for the sponsor department to exercise meaningful oversight of the ALB's strategy and performance, pay arrangements and/or major financial transactions, eg by monthly returns, standard delegations and exception reporting. ALBs should refer to their sponsor departments any issues which appear novel, contentious or repercussive; in turn the sponsor department may need to seek Treasury consent. The sponsor department's resource accounts consolidate those of its ALBs so its accounting officer must be satisfied that the consolidated accounts are accurate and not misleading.

3.8.4 Exceptionally, the accounting officer of a sponsor department may need to intervene if an ALB drifts significantly off track, eg if its budget is threatened, its systems are badly defective or it falls into disrepute. This may include replacing some or all of the leaders of the ALB, possibly even its accounting officer.

3.8.5 There are some sensitivities about the role of the accounting officer in an ALB which is governed by an independent board, eg a charity or a company. The ALB's accounting officer, who will normally be a member of the board, must take care that his or her personal responsibilities do not conflict with his or her duties as a board member. In particular, the accounting officer should vote against any proposal which appears to cause such a conflict; it is not sufficient to abstain.

3.8.6 Moreover, if the chair or board of such an ALB is minded to instruct its accounting officer to carry out a course inconsistent with the standards in box 3.1, then the accounting officer should make his or her reservations clear, preferably in writing. If the board is still minded to proceed, the ALB accounting officer should then:

- ask the accounting officer of the sponsor department to consider intervening to resolve the difference of view, preferably in writing;
- if the board's decision stands, seek its written direction to carry it out, asking the sponsor department to inform the Treasury;
- proceed to implement without delay; and
- follow the routine in paragraph 3.4.4.

3.8.7 This process is similar to what happens in departments (section 3.4), allowing for the special position of the organisation's board, which will often have been appointed under statute.

3.9 In the round

3.9.1 It is not realistic to set firm rules for every aspect of the business with which an accounting officer may deal. Sometimes the accounting officer may need to take a principled decision on the facts in circumstances where precedents are of limited value. Should that happen, the accounting officer should be guided by the standards in box 3.1, adapted as need be. It is important that accounting officers seek good outcomes for the

public sector as a whole, respecting the key principles of transparency and parliamentary approval for management of public resources.

3.9.2 Where time permits, the Treasury stands ready to help accounting officers think such issues through. It is good practice to document decisions where the accounting officer has had to strike difficult judgements, especially where they break new ground..

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ANNEX 3.1 THE GOVERNANCE STATEMENT

It is fundamental to each accounting officer's responsibilities to manage and control the resources used in his or her organisation. The governance statement, a key feature of the organisation's annual report and accounts, manifests how these duties have been carried out in the course of the year. It encompasses discussion of both corporate governance and risk management.

Purpose

A.3.1.1 Each accounting officer (AO) delegates responsibilities within his or her organisation so as to control its business and meet the standards set out in box 3.1 (see chapter 3). The systems used to do this should give adequate insight into the business of the organisation and its use of resources to allow the AO to make informed decisions about progress against business plans and if necessary steer performance back on track. In doing this the AO is usually supported by a board.

A.3.1.2 These responsibilities are central to the AO's duties. To carry them out the AO needs to develop a keen sense of the risks and opportunities the organisation faces. In the light of the board's assessment of the organisation's appetite for risk, the AO needs to decide how to respond to the evolving perceived risks.

A.3.1.3 The governance statement, for which the AO takes personal responsibility, brings together all these judgements as part of the annual report and accounts. It should give the reader a clear understanding of the dynamics of the business and its control structure. Essentially, it records the stewardship of the organisation to supplement the accounts, providing a sense of how vulnerable the organisation's performance is or might be; and of how successfully it has coped with the challenge it faces.

Preparing the governance statement

A.3.1.4 The governance statement is published in each organisation's annual report and accounts. It should be assembled from work through the year to gain assurance about performance and insight into the organisation's risk profile, its responses to the identified and emerging risks and its success in tackling them.

A.3.1.5 There is no set template for the governance statement.

A.3.1.6 The AO and the board have a number of inputs into this process:

- the board's annual review of its own processes and practices, informed by the views of its audit committee on the organisation's assurance arrangements;
- insight into the organisation's performance from internal audit, including an audit opinion on the quality of the systems of governance, management and risk control;
- feedback from the delegation chain(s) within the organisation about its business, its use of resources, its responses to risks, the extent to which in year budgets and other targets have been met, and any other internal accountability mechanisms; including:
 - bottom-up information and assessments to generate a full appreciation of performance and risks as they are perceived from within the organisation;
 - end-to-end assessments of processes, since it is possible to neglect interdependent and compounded risks if only the components are considered;

- a high level overview of the organisation's business so that systemic risks can be considered in the round;
- any evidence from internal control failures or poor risk management;
- material from any arm's length bodies (ALBs) connected with the organisation which may shed light on the performance of the organisation or its board.

A3.1.7 It is important that the governance statement covers the material factors affecting the organisation in the round, not missing out the more serious (if remote) risks¹, emerging technology and other cutting edge developments. It should also mention any personal or confidential matters in suitably careful terms², with details reported to the external auditor.

Content of the governance statement

A3.1.8 With the board's support, it is for the AO to decide how to:

- organise the governance statement;
- take account of input from within the organisation and from the board and its committees;
- integrate information about the organisation's ALBs, some of which may be material to the consolidated organisation.

A3.1.9 Box A.3.1A summarises subjects that should always be covered

box A.3.1A essential features of the governance statement

- the governance framework of the organisation, including information about the board's committee structure, its attendance records, and the coverage of its work;
- the board's performance, including its assessment of its own effectiveness;
- highlights of board committee reports, notably by the audit and nomination committees;
- an account of corporate governance, including the board's assessment of its compliance with the *Corporate Governance Code*, with explanations of any departures;
- a risk assessment, including the organisation's risk profile, and how it is managed, including, subject to a public interest test:
 - any newly identified risk;
 - a record of any ministerial directions given;
 - a summary of any lapses of data security, other than trivial ones.

A3.1.10 All the items in this box are important. The risk assessment is critical. This is where the AO, supported by the board, should discuss how the organisation's risk management and internal control mechanism work, and why they were chosen to deliver reasonable assurance about prevention, deterrent or other appropriate action to manage the actual and potential problems facing the organisation. Avoiding lengthy description of process, it should assess the evidence about the effectiveness in practice of the risk

¹ Including the external risks identified in the National Risk Assessment

² As set out in the Security Policy Framework

management processes in place. In doing so it should face frankly up to any revealed deficiencies as risks have materialised.

A3.1.11 In putting together the governance statement, the AO needs to take a view on the extent to which items are significant enough to the welfare of the organisation as a whole to be worth recording. There are no hard and fast rules about this. Some factors to take into account are suggested in box A.3.1B.

box A.3.1B deciding what to include in the governance statement

- might the issue prejudice achievement of the business plan? – or other priorities?
- could the issue undermine the integrity or reputation of the organisation?
- what view does the board's audit committee take on the point?
- what advice or opinions have internal audit and/or external audit given?
- could delivery of the standards expected of the AO (box 3.1) be at risk?
- might the issue make it harder to resist fraud or other misuse of resources?
- does the issue put a significant programme or project at risk?
- could the issue divert resources from another significant aspect of the business?
- could the issue have a material impact on the accounts?
- might national security or data integrity be put at risk?

External audit

A3.1.12 The organisation's external auditor will review the governance statement for its consistency with the audited financial statement. The external auditor may report on:

- any inconsistency between evidence collected in the course of the audit and the discussion of the governance statement; and/or;
- any failure to meet the requirement to comply with or explain departures from the *Corporate Governance Code* or any other authoritative guidance.