

PUBLIC AUDIT FORUM

Propriety and Audit
in the Public Sector

August 2001



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THE PUBLIC AUDIT FORUM

Public sector audit has a key part to play in safeguarding public money, ensuring proper accountability, upholding proper standards of conduct in public services and helping public services achieve value for money.

The Public Audit Forum was established in 1998 by the then four national audit agencies: the National Audit Office (NAO), the Northern Ireland Audit Office (NIAO), the Audit Commission for Local Authorities and the National Health Service in England and Wales, and the Accounts Commission for Scotland. It brings together the audit agencies on a purely advisory basis to provide a focus for developmental thinking about public audit. It has a remit to build on the existing co-operation between the national audit agencies: to enhance the efficiency and effectiveness of public audit, to provide a strategic focus on issues cutting across their work and to help develop broadly consistent approaches to public audit.

A key element in the Forum is a consultative forum which draws on the experience and expertise of public auditors, the bodies they audit, the auditing profession and the wider community. The current membership is set out overleaf.

The Public Audit Forum has published the following reports to date:

The Principles of Public Audit: a statement by the Public Audit Forum (October 1998)

The Service which Auditees can Expect from Public Auditors: a consultation document (October 1998)

Implications for Audit of the Modernising Government Agenda: a paper by the Public Audit Forum (April 1999)

What Public Sector Bodies can expect from their Auditors: a consultation paper (June 1999)

What Public Sector Bodies can expect from their Auditors (final paper March 2000)

Propriety and Audit in the Public Sector: a consultation paper (May 2000)

Data Matching and the Role of Public Sector Auditors: a consultation paper (August 2000)

Audit Implications of Electronic Service Delivery in the Public Sector (April 2001)

This report, past publications and other information about the Public Audit Forum are available on its web site at www.public-audit-forum.gov.uk.

The Secretary is David Corner, who can be contacted on 020 7798 7529 at the National Audit Office, 157-197 Buckingham Palace Road, London SW1W 9SP.

MEMBERSHIP OF THE CONSULTATIVE FORUM OF THE PUBLIC AUDIT FORUM

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Deputy Comptroller and Auditor General
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Convention of Scottish Local Authorities

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David Corner

National Audit Office (Secretary)

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Foreword

Public servants are expected to observe the highest standards of conduct. They must act with propriety, particularly in the care and management of public funds. The Nolan Committee's first report "Standards in Public Life" (May 1995) used a broad definition of propriety, stating:

"We take propriety to encompass not only financial rectitude, but a sense of the values and behaviour appropriate to the public sector."

However, the definition of appropriate behaviour is not constant but changes over time with public and parliamentary expectations. This means that it is necessary to understand public and parliamentary expectations in order to fully appreciate the nature of propriety.

While acknowledging the wide compass of propriety, public sector auditors are especially concerned with matters which have an impact on the finances or governance of the bodies they audit. This focus is indicated in the definition of propriety provided in HM Treasury's guidance *Government Accounting*:

"Propriety is the requirement that expenditure and receipts should be dealt with in accordance with Parliament's intentions and the principles of Parliamentary control, including the conventions agreed with Parliament."

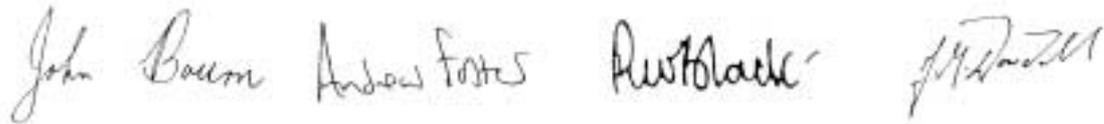
It should, however, be noted that *Government Accounting* is directed at UK central government bodies and does not provide a universal definition of propriety. And even within that sector, the conventions agreed with Parliament are not drawn together or set down in one place.

All of the national audit agencies have reported on cases of impropriety and expect that their auditors will be aware of propriety issues when undertaking their work. It was for this reason that the Forum decided to prepare a paper on the subject.

This paper is a guide, rather than a standard setting document. Its purpose is to promote a common understanding of what constitutes propriety in the United Kingdom public sector, and as such it is aimed at those involved in the governance, management and audit of organisations in the public sector. We hope that the paper will help public sector managers understand what is expected of them and clarify the type of work that auditors of public sector bodies may undertake in this area. It should also help inform private and voluntary sector bodies dealing with the public sector of Parliament's expectations of public sector activity. For public sector auditors it should provide a handy work of reference to inform the judgements they make in planning, executing and reporting on their work.

While propriety is not amenable to precise definitions or standards, being a reflection of Society's changing expectations of the public service, much can be learnt from studying the views on what is expected of public bodies and their employees set out in reports on the subject and in codes of conduct. Examples of cases where impropriety has been reported are similarly helpful. The larger part of the paper therefore brings together these issues in a structured format. The remainder of the paper explores the ways in which auditors have responded to the expectation that they should take action where impropriety has occurred in public sector bodies.

We consider that this paper should be of particular interest both to the management of bodies across the public sector and to all those who undertake audits in the public sector. We are therefore pleased to endorse this paper.

The image shows four handwritten signatures in black ink, arranged horizontally. From left to right, they are: 'John Bourn', 'Andrew Foster', 'Robert Black', and 'John Dowdall'. The signatures are written in a cursive, slightly slanted style.

Sir John Bourn Comptroller & Auditor General and Auditor General for Wales, National Audit Office, 157-197 Buckingham Palace Road, London SW1W 9SP

Sir Andrew Foster Controller of Audit, The Audit Commission for Local Authorities and the National Health Service in England and Wales, 1 Vincent Square, London SW1P 2PN

Robert Black Auditor General for Scotland, 110 George Street, Edinburgh EH2 4LH

John Dowdall Northern Ireland Comptroller and Auditor General, Northern Ireland Audit Office, 106 University Street, Belfast BT7 1UE

Introduction

"This country has long enjoyed a reputation for the honour and integrity of its public institutions. That reputation has been based upon a widely shared tradition of public service. All responsible individuals, including politicians, public servants of all kinds, have a duty to sustain this tradition ..."
(Nolan Committee)

Purpose and scope

1. The scrutiny of the standards employed in the conduct of public business, highlighted by the Committee of Public Accounts and the Nolan Committee, together with the ever changing public sector environment, has led to a focus on propriety, regularity, governance and accountability. This paper addresses propriety, as set out in box 1.

Box 1: The purpose of this paper

The purpose of this paper is to provide management and auditors with an understanding of *propriety* in the public sector and the implications for its audit. It covers the following issues:

- ◆ the concept of propriety, drawing on Parliament's expectations;
- ◆ failures of propriety;
- ◆ safeguards against failures of propriety;
- ◆ audit approach to propriety.

2. The issues raised affect bodies and their auditors across the public sector and are not restricted to any particular segment or specialism. Box 2 sets out this paper's intended audience. While the paper discusses the implications of propriety on audit, and provides examples to underpin its content, there is no intention to replace specific guidance issued for parts of the public sector. This paper should be read in conjunction with such guidance.

Background

3. The issue of propriety lies at the very heart of public administration. The frameworks that have been developed to ensure the highest standards of propriety in the delivery of public services have evolved over many years. There is no definitive code or guidance that sets out exactly all the activities or behaviours that will infringe these standards.

Box 2: The intended audience of this paper

The intended audience is those involved in the management, governance, administration and audit of organisations that derive their funding, either in whole or substantially, from the public purse. We hope that management find this paper to be a useful starting point when devising or revising controls, governance arrangements and codes of conduct. We think that it would be appropriate for copies to be made available to board members, audit committee members, relevant finance staff and internal auditors. (We are happy for the paper to be freely copied and are willing to provide additional original copies.) The paper should give management an indication of the range of roles that auditors play with regard to propriety as well as giving auditors an overview. We also hope that this paper will be a particularly useful guide to those who are embarking on a partnership or contractual relationship with public bodies.

4. Today's standards of propriety, against which the United Kingdom public sector operates, date back to the nineteenth century. The Northcote and Trevelyan report of 1853 condemned the nepotism and incompetence and other defects in the Civil Service and initiated fundamental change that led to the development of a framework of principles and standards in public life. This framework draws on the traditional values of public service and is underpinned by legislation, case law, internal codes and rules, well established procurement procedures and public scrutiny of performance, including audit. Most of these values have been reaffirmed over recent years, reflecting how important it is for standards to be reviewed and scrutinised to ensure they remain at the heart of public life.
5. In January 1994, the Committee of Public Accounts (PAC) issued a report on the "Proper Conduct of Public Business". This report drew on several of the Committee's earlier reports to highlight "a number of serious failures in administrative and financial systems and controls within departments and other public bodies, which have led to public money being wasted or otherwise improperly spent." These cases highlighted changes in administrative culture and led the Committee to argue:

"it is important to ensure that proper standards are maintained in the conduct of public business... Some allege that the drive for economy and efficiency must be held back to some extent because of the need to take specific care with public money. Others argue that if economy and efficiency are to be forcibly pursued then traditional standards must be relaxed. We reject both these claims... Quite apart from the important moral and other aspects involved, we consider that any failure to respect and care for public money would be a most important cause of a decline in the efficiency of public business. But there is no reason why a proper concern for the sensible conduct of public business and care for the honest handling of public money should not be combined with effective programmes for promoting economy and efficiency.. We believe it is important that the drive to provide improved services at reduced cost should be sustained and that this drive should not be stifled by unnecessary bureaucracy. At such time it is even more essential to maintain honesty in the spending of public money and to ensure that traditional public sector values are not neglected in the effort to maximise economy and efficiency."

- 6.** In October 1994, Lord Nolan was invited to chair a Committee to enquire into the growing public concern about standards in public life, and the Committee has subsequently issued a series of reports on various aspects of such standards. The Committee's First Report found that the erosion of public confidence in the holders of public office was a serious matter and it made numerous recommendations to help detect and deter wrongdoing with the aim of restoring respect for ethical values inherent in the idea of public service. The Committee warned that unless the strictest standards are maintained, and where necessary restored, corruption and malpractice can become a part of the way of life.
- 7.** The Committee also stressed that changes in the public sector had increased the need to take action. Decentralisation, contracting out, the greater interchange between public and private sectors and more use of short term contracts mean that the assimilation of a public service culture by everyone operating in that environment cannot be assumed. Public servants need to be told what is expected of them, and the message needs to be systematically reinforced.

The Concept of propriety

The definition of propriety

- 8.** Propriety is concerned with the way in which public business should be conducted. There are a number of different interpretations of this concept. Dictionary definitions refer variously to 'appropriateness', 'rightness', 'correctness in behaviour or morals', 'conformity with convention in conduct'. In the context of public administration, the Nolan Committee has defined propriety as encompassing:

"not only financial rectitude, but a sense of the values and behaviour appropriate to the public sector."

Similarly the Public Accounts Committee has used phrases such as 'the standards of public conduct' and 'care for the honest handling of public money' and 'traditional public sector values'.

- 9.** While these concepts of propriety are wide, public sector auditors are especially concerned with the financial aspects of propriety, that is the proper conduct of affairs that have financial implications. This is embodied in the definition of propriety set out in Government Accounting:

"Propriety is the requirement that expenditure and receipts should be dealt with in accordance with Parliament's intentions and the principles of Parliamentary control, including the conventions agreed with Parliament."

- 10.** It should be noted, however, that Government Accounting is directed at UK central government bodies and does not provide a universal definition of propriety. And even within that sector, the conventions agreed with Parliament are not drawn together or set down in one place.

- 11.** The Auditing Practices Board provides a useful footnote that distinguishes propriety from regularity in its revised Practice Note 10, Audit of Financial Statements of Public Sector Entities in the United Kingdom:

"Whereas regularity is concerned with compliance with appropriate authorities, propriety goes wider than this and is concerned more with standards of conduct, behaviour and corporate governance. It includes matters such as fairness and integrity, the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance."

(The Auditing Practices Board practice note does not set out to formally define propriety or give guidance on the auditor's responsibilities regarding propriety.)

Parliament's expectations

12. An understanding of propriety requires an appreciation of Parliament's expectations about the way public business is to be conducted. Parliament has not set out any fixed definition of propriety, but its expectations are clear from the comments of its Committee of Public Accounts (PAC) and further details are given at paragraph 38 onwards.

The principles of propriety

13. While the principles underlying the concept of propriety hold true across different parts of the public sector, their practical application may vary. This is likely to evolve as values and behaviour which underpin the cultures of organisations are affected by internal and external pressures for change.
14. The Nolan Committee set out seven core principles inherent in the ethics of public service that should reflect the expected values and behaviour for the operation of the public sector. These 'principles of public life' have been endorsed by Government and are set out in box 3 below.

Box 3: The Nolan Committee's Seven Principles of Public Life

Selflessness

Holders of public office should take decisions solely in terms of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family, or their friends.

Integrity

Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might influence them in the performance of their Official duties.

Objectivity

In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.

Accountability

Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.

Openness

Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

Honesty

Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.

Leadership

Holders of public office should promote and support these principles by leadership and example.

- 15.** The central themes of the seven principles that relate to propriety are:
- ◆ the avoidance of bias through conflict of interest, whether actual or potential;
 - ◆ the avoidance of personal gain from public funds;
 - ◆ openness and accountability.
- 16.** Underlying the concept of propriety, though not expressly mentioned in the seven principles, are also:
- ◆ the proper stewardship of public funds;
 - ◆ the duty to uphold the law.
- 17.** The Nolan principles are addressed to the 'holders of public office'. In other words, propriety is likely to relate much more to the behaviour of individuals, or groups of individuals, than to organisations. Where organisations are seen to have failed in their "corporate" responsibilities in this area, it is invariably the actions (or inactions) of individuals associated with them which bring about such failure.
- 18.** Acts of impropriety may be legally distinct from omissions of propriety, even though the effects on public sector organisations are often the same. The distinction is important when dealing with individuals accused of impropriety.
- 19.** An act of impropriety depends very much on a person knowingly committing it while having a motive involving some aspect of personal gain or unworthy objective. Hence "wilful misconduct", when used in this context, is an accepted definition. Public servants should conform to standards of correctness in behaviour and morals, and such standards should relate to fairness, integrity and the avoidance of waste and extravagance. However, there are examples of breaches of these principles that do not stem from an unworthy motive and/or are not always entered into knowingly. Some, for example, could be attributed to incompetence. Given an absence of motive and knowledge, such instances may not be considered acts of impropriety but rather as omissions of propriety. Reckless indifference in the conduct of duties, however, could be construed as wilful misconduct and would constitute an act of impropriety.

Relationship of propriety to other concepts

- 20.** Propriety is concerned with standards of conduct, behaviour and, in particular, fairness, integrity and the maintenance of a responsible attitude to public office. The concept of propriety is different, although not unrelated, to other concepts of behaviour, both positive and negative. Other relevant concepts are set out below. In the determination of propriety, it is appropriate to reflect upon the relevance of those other concepts before reaching judgement. The behaviour in question may be more appropriately analysed in terms of these other concepts.

21. Accountability is the process whereby public service bodies and the individuals within them are held to account for their decisions and actions, including their stewardship of public funds and all aspects of performance. Individuals and organisations can be accountable to different constituencies in different ways. Individuals are, in the first instance, accountable within their organisations through internal governance procedures and through the scrutiny of internal audit, while bodies in the public sector are ultimately accountable to the public through the democratic process. Public sector bodies and holders of public office are also separately accountable for the use of public funds (and this is assisted by appropriate scrutiny by external audit). This particular aspect of accountability is achieved by all parties having a clear understanding of their responsibilities, having clearly defined roles through robust structures and by providing an account of:

- ◆ the setting and achievement of operational objectives and priorities;
- ◆ proper and efficient use of public money;
- ◆ management processes;
- ◆ quality of service(s) provided.

22. Intentionally avoiding or confounding the process of ensuring accountability by blurring roles or weakening structures is in itself improper as it will hinder the reporting of stewardship of public resources. Unintentional weakening of accountability may facilitate failures of propriety and improper behaviour by, for example, presenting opportunities for private gain from access to public money.

23. Regularity, or legality, is concerned with compliance with authorities in terms of authorising legislation and associated regulations. While the concept of propriety is underpinned by compliance with authorities, and in particular with legislation, it goes wider than this and covers conduct and behaviour unconnected with authorities. Non compliance with authorities may not always constitute an act of impropriety. Where it is inadvertent, it may be an omission of propriety, depending on the circumstances. Impropriety more usually involves a deliberate act or a wilfully careless one.

24. Probity is generally accepted to be equivalent to honesty and integrity and is central to the Nolan principles. Probity can also be considered as the avoidance of fraud or corruption. Probity is therefore central to the concept of propriety. However, while failures of probity are likely to be contrary to law, many failures of propriety may be less clear cut.

25. Value for money is concerned with the establishment of arrangements for securing economy, efficiency and effectiveness in the use of resources. A failure to secure value for money may be indicative of poor management but does not necessarily constitute improper behaviour. Improper behaviour might result from the wilful failure to avoid waste, for example, through entering into significant unfavourable contracts. Conversely, there may be occasions where better value for money may be obtained from a

particular course of action, but to follow such a course would involve improper behaviour. Where there seems to be such a conflict, public servants will need to be able to demonstrate that they have properly exercised discretion in the public interest.

- 26. Fraud** is generally accepted to mean the use of deception to obtain financial advantage. By definition, all frauds are improper, in the meaning of contrary to expected standards of conduct. However, the concept of impropriety can go much wider than fraud and improper behaviour, and will not necessarily be contrary to law or capable of prosecution.
- 27. Corruption** is associated with the exercise of influence and is seen as the offering, giving, soliciting or acceptance of any inducement or reward which could influence the actions taken by an organisation, its board (or members) or officers. By definition, all acts of corruption are improper.
- 28.** While propriety shares many of the characteristics of other more readily identifiable concepts, judgements on propriety must necessarily be subjective, being dependent on the particular circumstances of the case and, most crucially, on Parliament's expectations of what is proper for a public official and on proportionality. The primary test is therefore to consider the attitude of the Committee of Public Accounts. Such attitudes are illustrated in box 4, paragraph 38.
- 29.** While the foregoing are more in the nature of concepts, it is important to reflect on structural issues which impact on this area and their definitions, particularly governance and internal control.
- 30. Governance** can be defined as the systems and frameworks by which organisations are directed and controlled. Good governance of an organisation encompasses the establishment of proper standards of behaviour, for example, through codes of conduct. But as governance also covers areas such as internal control, reporting and accountability, it goes beyond matters of behaviour and is conceptually different to propriety.
- 31. Internal control** systems constitute an organisation's network of systems necessary to provide reasonable assurance that organisational objectives will be achieved. In doing so, they provide a safeguard over the use of public money and resources. A breach of internal control does not itself constitute an improper action. However, wilful disregard of internal controls or failure to establish internal controls in an area of material financial risk might constitute impropriety, since it would constitute an irresponsible attitude to the stewardship of public funds. It should be noted, however, that not all impropriety arises from abuses and failures of internal controls.

Sources of guidance on propriety

- 32.** There is guidance on propriety from various sources, generally dependent on the specific part of the public sector concerned. The Appendix provides a bibliography of guidance available on propriety and propriety-related issues, by sector and by subject. The web-site version of this document contains links to the major reference sites.

- 33.** It is recognised that certain of the areas covered are strictly those of governance. They are included, however, as they provide the parameters of behaviour expected of those responsible for the operations of public sector organisations.
- 34.** There are also sources of guidance that cut across sectors but apply to particular professions, or members of particular professional institutes. For example, the Chartered Institute of Public Finance & Accountancy (<http://www.cipfa.org.uk>) has produced, for its members, a consultation draft for a revised standard of professional practice on ethics. This specifically addresses issues of conduct.

Laws on Corruption

- 35.** The general provisions in criminal law in relation to corruption in public service are long standing. Board members and councillors, together with employees of public bodies are covered by the Prevention of Corruption Act 1906. In essence, it is an offence for someone corruptly to accept, obtain, agree to accept or attempt to obtain any gift or consideration. This applies if it is an inducement or reward for doing, or not doing, anything or showing favour, or disfavour, to any person while acting for another, including an employer.
- 36.** More stringent provisions may apply to corruption involving members or employees of public bodies under the Prevention of Corruption Act 1916. Employees of public bodies may be required to prove that the receipt of payment or other consideration from someone seeking to obtain a contract is not corrupt. (The provisions of this Act do not, however, appear to be compatible with the Human Rights Act 1998, which requires that accused persons be presumed to be innocent.)
- 37.** The Public Bodies Corrupt Practices Act 1889 has certain other provisions, including possible disqualification from office, that apply only to members and employees of public bodies. There is also a common law offence of misconduct in public office. This includes receipt of a bribe by someone who has a duty to do something in which the public is interested, either to act in a manner contrary to his duty or to show favour in the discharge of his functions.

Committee of Public Accounts

- 38.** The Committee of Public Accounts (PAC) was established in 1861 with a primary purpose of examining the accounting for, and the regularity and propriety of, expenditure. The reports issued by the PAC provide important insight into Parliament's expectations regarding the conduct of public business and the general standards of governance and propriety that public bodies are expected to uphold. A representative selection of comments made by PAC in the past five years is given in box 4 below.

Box 4: Parliament's expectations - a selection of the Public Accounts Committee's comments on propriety

1. "We consider that arrangements to ensure proper arm's length relationships are essential in cases where Non-Departmental Public Bodies have significant financial relationships...with subsidiary companies.

"We are particularly concerned that the former Director General and Accounting Officer and the former Finance Director had conflicts of interest...although the former Director General had resigned as a director of S...Limited when potential conflicts of interest had been brought to his attention, he had remained a director of the subsidiary company, B...Limited.

"The Council created a complex structure of charitable and trading companies beyond the control of the sponsoring department. We note with serious concern that the holding company for these activities, the Trust Company, having been set up apparently to trade outside the control of the Department, was largely publicly funded.

"We are concerned that, despite Treasury guidance, the Department and the Council have not secured the necessary safeguards for assets held by the Trust Company.

"We are very concerned that the Council awarded a contract to B...Limited for twenty years to manage the Council's annual exhibition and seminar as this does not allow the Council regularly to test the market.

"We are concerned that...the contract was let, the change in contractor was, nevertheless, made expressly to allow redundancy money to be paid to staff who were then re-employed by the management buy-out company." (PAC 2nd report 1994/95)

2. "To avoid any question of impropriety, detailed reasons should always be recorded whenever a contract is not awarded to a tenderer who submits the lowest bid and is judged capable of meeting the key performance criteria. This would also provide a basis for informing the other short-listed firms why their bids had been unsuccessful." (PAC 6th report 1994/95) .

3. "We find it astonishing that the management at the embassy also allowed their staff to use public money to gain up to £670,000 from manipulating the local currency markets.

"It is clearly unsatisfactory that...was able to gain a kick-back of \$50,000 through negotiating what may have been a needlessly expensive five-year lease for the ambassador's residence. We do not agree that there was no loss to public funds as a consequence. At the very least the bribe paid to...could have been taken off the price of the lease.

"We are concerned that there were no job specifications for locally-engaged staff, that to...was able to recruit local staff known to him and that those appointed may not have been the best candidates. We are disturbed that some embassy staff were under an obligation to...and therefore subject to pressure from him, for example not to apply the full range of checks over transactions in which...or others may have had an improper interest. In such a situation the scope for fraud and corruption was enhanced and irregularities made difficult to detect." (PAC 33rd report 1994/95)

4. " We are disturbed that so many conflicts of interest should have arisen on this one project...such conflicts give rise to potential dangers for the taxpayer, not only in terms of value for money but of propriety in the use of public money. We emphasise that nobody involved in public sector transactions should have the opportunity to influence business in their own favour.

"We are concerned that orders for items to a value of £23.4 million were placed without competition... we expect all publicly-funded procurement to be conducted as far as possible on a competitive basis in order to promote value for money and to act as a safeguard against impropriety.

"It was clearly wrong for some bidders to have been given more time to produce their documentation when this extension was not made available to all of them. And we agree with the Administration that it is not acceptable for a bid to be altered after the opening of sealed tenders. (PAC 12th report 1996/97)

Box 4: Parliament's expectations - a selection of the Public Accounts Committee's comments on propriety continued...

5. "The auditors estimated that Mr... had authorised the charging to the Corporation of £9,210 of his own private expenditure and a further £2,080 of private expenses for other members of staff. The Committee considers that Mr...'s conduct, while Chief Executive..., did not meet the standards expected of those entrusted with the use of public funds, notably in his handling of travel and personal expenditure." (PAC 25th report 1996/97)
6. "The former Institute Director was able to draw up his own rules for handling grievances or complaints, even for complaints involving himself. As a result, some individuals had to use outside channels such as the press... This was a totally unacceptable way to deal with the legitimate concerns of staff about the management of the Institute and its governance." "We consider it inappropriate that severance settlements should include increased benefits to reflect the personal circumstances of individuals." (PAC 26th report 1998/99)
7. "We are deeply concerned at the extravagant spending particularly on overseas trips by the Principal and Deputy Principal. Apart from the total cost - over £210,000 - and excessive individual expense items, the absence of these two... can only have added to the management problems." (PAC 37th report 1998/99)
8. "We condemn the catalogue of mismanagement at the College's Training Shop including what seems to us to be an almost total disregard for basic tenets of financial control, and exposure to potential conflicts of interest. For example, over £13,000 was paid for driving services provided by a son of the head of the Shop, but there was no evidence that the work was competed." (PAC 2nd report 1999/00)

39. The PAC Report on "The Proper Conduct of Public Business"¹ is also a valuable source for details of failings in key areas of propriety. It emphasises that, at a time when fundamental changes are taking place in the way in which government departments and public bodies carry out their work, it is important to ensure that proper standards are maintained in the conduct of public business. A number of failings are set out in key areas:

- ◆ financial control;
- ◆ compliance with rules;
- ◆ stewardship of public money and assets;
- ◆ getting value for the taxpayers money.

40. A checklist for each of these failings is set out detailing points that public bodies need to keep in mind in order to guard against the risk of such lapses in the proper conduct of public business. The aim is to help all departments and public bodies to avoid future departures from the high standards demanded by Parliament and the public.

¹ House of Commons, Committee of Public Accounts 8th Report 1993-94 The Proper Conduct of Public Business

The Nolan Committee on Standards in Public Life

- 41.** The Nolan Committee's First Report (May 1995) covered the standards in public life relating to Members of Parliament, Ministers and Civil Servants and Executive Quangos and NHS bodies. It made a number of recommendations to promote higher standards in the conduct of public servants, including the seven principles of public life (see box 3, paragraph 14).
- 42.** The Committee's work has gone on to consider standards of conduct in other areas of the public sector. The Second Report (May 1998) covers standards in local public spending bodies (further and higher education bodies (including universities), grant maintained schools, registered housing associations, training and enterprise councils and local enterprise companies). The Third Report (July 1997) covers standards of conduct in local government in Great Britain. The Fourth Report (November 1997) reviews progress on implementation of the Committee's recommendations made in the First and Second Reports about executive non-departmental public bodies, NHS bodies and local spending bodies.

Comptrollers and Auditors General

- 43.** In the United Kingdom, the Comptroller and Auditor General (C&AG) is required to provide independent assurance, information and advice to Parliament on the proper accounting for, and use of, public resources. In addition to reporting on the financial statements of central government bodies, the Comptroller and Auditor General may report to Parliament any matters relating to the accounts, including failures of propriety and financial control. These reports, which may be submitted with the audited accounts or presented separately, deal with failures of propriety that the C&AG considers Parliament should be informed of. In determining whether Parliament should be informed of any failure of propriety, the C&AG will consider the size, nature and wider importance of the issue as well as any previous interest expressed by the Public Accounts Committee. These reports may form the basis of a further enquiry by the Public Accounts Committee.
- 44.** Broadly speaking, central government expenditure that has been devolved to Scotland or Wales is now audited by the Auditor General of that country rather than the C&AG, though the latter reports on the funding provided to the devolved administrations from the consolidated fund. In the case of Northern Ireland, devolved expenditure is audited by the Northern Ireland Comptroller and Auditor General. Before devolution, the Northern Ireland Comptroller and Auditor General reported to the Westminster Public Accounts Committee on central government expenditure particular to Northern Ireland, but he now reports to the Northern Ireland Assembly's Audit Committee. Like the United Kingdom C&AG, his work includes reports on failures of propriety in Northern Ireland central government agencies.

Audit Commission

- 45.** The Audit Commission has not issued specific guidance on propriety. Its Code of Audit Practice incorporates the responsibility for auditors to review and, where appropriate, report on the arrangements put in place by audited bodies to maintain proper standards of financial conduct, as well as those relating to the prevention and detection of fraud and corruption.
- 46.** The Code of Audit Practice also contains a summarisation of statutory guidance and that produced by appropriate parties for local authorities and health bodies, such as the NHS Executive. It sets out that audited bodies should set in place proper arrangements for:
- ◆ implementing and monitoring compliance with appropriate corporate governance arrangements;
 - ◆ articulating and promoting appropriate values and standards across the organisation;
 - ◆ developing, promulgating and monitoring compliance with codes of conduct that advise members and officers of their personal responsibilities and expected standards of behaviour;
 - ◆ developing, promulgating and monitoring compliance with standing orders or financial regulations, including instructions on regulating the handling of contracts;
 - ◆ developing and implementing anti-fraud and corruption strategies;
 - ◆ developing and implementing arrangements for receiving and investigating allegations of breaches of proper standards of financial conduct, fraud and corruption.
- 47.** In addition, the Commission has issued:
- ◆ a *Fraud and Corruption Audit Manual*, which provides guidance and advice to auditors in carrying out work in relation to fraud and corruption. This includes suggested controls as well as audit tests;
 - ◆ national reports and annual updates on the quantity of reported fraud and corruption within Local Government and the NHS;
 - ◆ various Technical Releases on the expected controls and the audit approach to fraud and corruption, including, for example, the implications of a public interest report on a metropolitan borough council, which covered issues as to the way the authority handled gifts and hospitality, the letting of contracts and failure by members to meet appropriate standards of conduct.

Accounts Commission for Scotland

48. While in England and Wales reports and issues that result from local authority audits are made by auditors, in Scotland they are made by the Controller of Audit to the Accounts Commission. The Commission then considers the reports together with any views of the councils or interested individuals and then makes recommendations. Where there is a question of impropriety leading to loss the Controller of Audit issues a special report. There are a few past examples of where the Secretary of State implemented a surcharge order. As with England and Wales, surcharging has, however, now been abolished in Scotland.

49. The Commission has issued two papers on major areas of risk arising from re-organisation:

◆ *Local government re-organisation and the stewardship of public funds;*

◆ *A matter of trust: guidance on NHS trust re-organisation.*

These documents deal with, among other things, issues of propriety and good governance in the re-organisation process and the accompanying risks that are involved.

50. Questions of propriety in relation to arms-length bodies are dealt with in the Commission's *Code of Guidance on Funding External Bodies and Following the Public Pound*, produced jointly with Convention of Scottish Local Authorities (CoSLA), together with operational guidance on the application of the Code. They explain the importance of the principles of openness, integrity and accountability in the relationships between local authorities and external bodies. This Code is particularly relevant in these days of partnership and outsourcing, and it covers requirements for stating the purpose of funding, financial regimes, monitoring agreements, representation, limitations and accountability.

Auditor General for Scotland (AGS)

51. From 1 April 2000, the Auditor General for Scotland is responsible for reporting to the Scottish Parliament on accountability for the resources of the Scottish Executive, the NHS in Scotland and other bodies in receipt of funds voted by the Parliament. His function is one of the essential elements of the accountability framework set out in the Scotland Act 1998 and the Scottish Parliament's Public Finance & Accountability (Scotland) Act 2000. Audit Scotland provides services to both the Auditor General for Scotland and the Accounts Commission.

Auditor General for Wales (AGW)

52. In Wales, following appointment on 1 June 1999 under the Government of Wales Act 1998, the Auditor General for Wales is responsible for reporting to the National Assembly for Wales on its accounting for resources voted to it by Parliament. In addition to audit, the Auditor General may also carry out examinations into the economy, efficiency and effectiveness with which the Assembly has used its resources in discharging its functions. The National Audit Office in Wales currently provides the services necessary for the Auditor General to carry out his duties.

Failures of propriety

53. There have been various recorded instances of failures of propriety over the past few years. A selection of these cases is set out in this section to illustrate the understanding of propriety put forward in this document. Not all the examples can be read across to every situation that arises in the public sector. Therefore, within the boxes in this section, further explanation and guidance to users is noted in italics. Frequently the cases may also have involved fraud or other breaches of law, and generally there is not a clear cut distinction.

54. The cases are set out under three broad headings:

- ◆ failures of the principle of fairness, in the treatment of staff, suppliers or customers, whether due to conflicts of interest or other reason;
- ◆ misuse of public assets or resources for personal or political purposes;
- ◆ failure to exercise reasonable stewardship over public assets or resources.

In many cases, the failure of propriety may cover more than one of the three headings.

55. There are a number of common underlying causes which have led or can lead to failures of propriety. These include:

- ◆ the presence of an overbearing individual as chief executive or chair of the board, or its equivalent, resulting in a bypassing or ignoring of controls or standards of propriety;
- ◆ the assumption of significant new responsibilities by the organisation to which management or board, or both, do not respond adequately;
- ◆ the culture of the organisation leading to unsatisfactory customs and practices and a reluctance to change or to address problems;
- ◆ ignorance of the rules or expectations of proper behaviour, especially in small organisations, due partially to a failure to educate and advise those with responsibility;
- ◆ over-zealousness to achieve objectives leading to a disregard for the appropriate operation of controls;
- ◆ a poorly designed or poorly operated control environment.

Failures of fairness

- 56.** Instances of failures of fairness frequently involve preferential treatment in making appointments either of contractors or of staff. This may or may not involve personal gain to the public officer through his or her relationship to the contractor or persons concerned. In this context, board members, or their equivalent, and management should ensure that their actions are fair and seen to be fair. Two areas where this perception may be called into question are the acceptance of hospitality and the existence of conflicts of interest.
- 57.** **Hospitality** is clearly a potentially dangerous area. The acceptance of generous hospitality by a public officer may create an obligation to the donor or the donor's organisation that can only be fulfilled through preferential treatment. While it is recognised that most offers of hospitality are not intended to create an obligation to the host, normal practice in the public and private sectors may differ. There may be problems of perception, and particular care needs to be exercised when a contract award or renewal is in prospect. The potential recipient always needs to have regard to the associated sensitivities.
- 58.** Although, strictly speaking, falling under the heading of 'inadequate stewardship of public funds', the giving of hospitality by public officials may also give rise to impropriety where it may be perceived as an inappropriate use of public funds. This is particularly so where the public officials benefit themselves from hospitality given to others or can expect to receive similar or more expensive hospitality in return.
- 59.** Obviously there should be a sensible balance. By way of example, a semi social lunch, at an unextravagant venue, in mid-term of a contract can be a very useful way of keeping in touch and supporting day-to-day relationships. On the other hand, lavish entertaining and foreign trips are rarely justified.
- 60.** While the instance may be considered trivial and unrelated to any particular business relationship, it should be defensible. Organisations will have their own codes of practice for dealing with, and recording, instances where hospitality is accepted. In general, the test for potential recipients, however, should be: "Could I satisfactorily defend this before the Public Accounts Committee and the public?". It would also be helpful if organisations defined their own limits of acceptability. Generally, any hospitality that is funded by public money, and which could be considered substantial, should be recorded.
- 61.** Similarly, **conflicts of interest** may affect the ability to be objective in one's dealings and to be open handed in the conduct of a body's affairs. Conflicts often arise over the appointment, for financial reward or otherwise, of connected parties. These may be family, personal connections, or business and political associates, including companies or businesses. The appointment may be as supplier, contractor, agent, employee, board member, consultant, and internal or external auditor.

62. When dealing with appointments as a supplier of goods or services, boards and management need to look beyond the bare facts of the case and to consider whether they may put their organisation and its officers and employees in a position where there is potential for conflict. Again, this should be avoided as it is often difficult for the public to differentiate between the potential for, and actual existence of, conflict. The perception of conflict may be as unfortunate as its reality.
63. Most organisations maintain registers of personal interests, but these tend to only record direct relationships, such as shareholdings or directorships. As the preceding paragraphs indicate, business connections may be through family or friends. Also, of themselves, registers do not prevent conflicts of interest, or the appearance of such conflicts. It is therefore advisable for the avoidance of doubt, that those in positions of influence should ensure that their **behaviour** is beyond question when considering the award of appointments or contracts. Box 5, below, illustrates unacceptable behaviour that results in failures of fairness.

Box 5: Examples of failures of fairness

- ◆ favouritism shown in employing family members;
(the exercise of favouritism when making appointments is improper, as is a failure to disclose an interest in relation to family, friends and business connections)
- ◆ appointment of an individual to head a department whose main supplier was owned by the appointee;
- ◆ letting of contracts by directors to an organisation run by their partners;
- ◆ formation of a company by a chief purchasing officer which became a significant supplier to a related organisation;
- ◆ failure to award a contract without clear reasons being given or recorded;
- ◆ avoidance of proper tendering procedures resulting in the award of contracts to a related company;
- ◆ use of an independent consulting firm to appraise bids for computer software and subsequent award of a software contract to them;
- ◆ awarding planning permission for major capital construction without disclosing the full facts concerning potentially competitive developments.

Misuse of public office for personal or political purposes

64. The misuse of public funds for personal or political purposes is mainly concerned with obtaining personal benefits from public office. This may frequently involve conflicts of interest from the outset and fraud or breach of regulations. Examples are given in box 6.

Box 6: Examples of misuse of public office for personal and political purposes

- ◆ expenditure on banners, tee shirts, balloons and other promotional items with a ruling group's logo and the slogan "Improving services, creating jobs"; (the authorisation of expenditure may be improper if committed knowingly for personal or political gain)
- ◆ arrangement for work to be done at the private home of a chief executive by a council's direct labour organisation
- ◆ foreign travel by senior management and board member without proper justification or clear benefit to the organisation;
- ◆ involvement by a chief executive in agreeing a contract allowing himself advantageous terms for early retirement;
- ◆ arranging for a management buyout of part of an authority's operations at less than market value.

Inadequate stewardship of public funds

65. Inadequate stewardship covers a range of issues from authorisation of waste and extravagance to failure to establish basic control procedures. Frequently it involves behaviour which must be considered unreasonable for a person in public office. Examples are given in box 7. A test of what is reasonable was set in local government in a legal case in which the judge stated that decisions made by authorities must:

- ◆ take account of all relevant factors;
- ◆ not be based on irrelevant factors;
- ◆ not be decisions no reasonable such body would have reached.

66. Acts of impropriety may have been committed in such instances where actions were carried out knowingly for personal gain or where there were instances of reckless indifference to proper procedures of stewardship. Incompetence may be the reason behind other omissions of propriety in this area.

Box 7: Examples of inadequate stewardship of public funds

- ◆ failure to take proper account of the likely costs of an industrial tribunal, as opposed to a negotiated settlement, where it is not clear that there is a justifiable case;
- ◆ award of increased salaries in final year of employment with the intention of increasing pension entitlements payable from public funds;
- ◆ bidding to be the host of a major sporting event without adequate consideration of the major effect on local taxation for years to come;
- ◆ excessive amounts paid on gifts to staff as reward for contribution to an efficiency scheme;
- ◆ lavish expenditure on anniversary celebrations;
- ◆ excessive or disproportionate expenditure on hospitality funded from the public purse;
- ◆ sale of public assets without adequate safeguards for their continuing operation;
- ◆ entering into capital commitments without apparent consideration of the financing available;
- ◆ failure to provide security for tangible assets after purchase of a major site;
- ◆ provision of misleading information about the financial arrangements for buying additional school accommodation;
- ◆ failure to install adequate financial and reporting controls over a major urban redevelopment;
- ◆ provision of a motor vehicle for the use of a family member. (In some circumstances, the provision of a subsidised leased vehicle, which may also be used by family members, will represent better value for money than the payment of car allowances. In such a case, it will need to be evident that optimum stewardship has been obtained and that the private benefit is incidental.)

Safeguards against failures of propriety

67. As the Nolan Committee stated:

"Nothing we can recommend can guarantee high standards of propriety...But appropriate safeguards minimise the risk of impropriety occurring or remaining undetected. These safeguards include:

- ◆ *expectations of standards of individual behaviour;*
- ◆ *appropriate internal controls to provide checks and balances against individual misconduct;*
- ◆ *external supervision to hold the organisation accountable.*

Above all, such safeguards help to create a climate and culture in which high standards of propriety are valued."

68. The principal internal safeguards against failures of propriety rest primarily on three factors:

- ◆ the general ethos of the organisation;
- ◆ the establishment of appropriate control and governance arrangements;
- ◆ the issue and promulgation of codes of conduct for board members (or their equivalent) and employees.

69. Public sector organisations will differ widely in their statutory and organisational composition, and in the way that they establish procedures and controls. Nevertheless, the basic safeguards against failures in propriety will have much in common, and these are outlined in this section. The detail of safeguards needed for any particular public sector body can only be identified after reference to the guidance that exists for its particular part of the public sector. A selection of such guidance is outlined in the appendix.

70. The prevention and detection of impropriety, and failures of propriety, is the ultimate responsibility of the board or its equivalent. In practical terms, management (in the sense of executive directors and senior officers) are responsible for identifying, assessing and managing risks to propriety. This involves establishing, operating and monitoring appropriate risk management and control arrangements, including codes of conduct. Management is also responsible for keeping its arrangements up to date. This process of development will entail not only acting on guidance that is directly relevant to a particular body but also staying informed of wider developments in public and parliamentary expectations. Board members and senior management will be helped in this regard by keeping a watching brief on the comments on issues of propriety that from time to time are made in Public Accounts Committee reports.

The ethos of the organisation

- 71.** The ethos of the organisation will depend on the example set by board and elected members and senior management, their attitude towards failures of propriety and other irregularities, and their personal behaviour.
- 72.** Board members and employees of public bodies are expected to conduct themselves in accordance with highest standards of personal behaviour, both at work and in their private life. In particular, as public servants, they should be trustworthy in the handling of public funds and demonstrate:
- ◆ probity in handling assets and resources entrusted to them;
 - ◆ care in safeguarding property and assets to ensure they are not stolen, abused or damaged;
 - ◆ appropriate handling of confidential information;
 - ◆ proper observance of the body's rules and procedures, particularly when accounting for cash;
 - ◆ economy, to avoid waste and extravagance;
 - ◆ personal honesty, for example, in claiming expenses and ensuring that official assets and resources are not used for private advantage.
- 73.** In dealing with matters of propriety, board members and senior employees should seek to ensure that:
- ◆ cases of failures of propriety are dealt with seriously and disciplinary action taken where appropriate;
 - ◆ procedures and controls are regularly reviewed and amended;
 - ◆ procedures and controls are implemented and seen to be implemented;
 - ◆ employees are encouraged to report suspicions of failures of propriety on a confidential basis (whistle-blowing). The existence of arrangements for employees to report, on a confidential basis, matters of concern in relation to probity, propriety, waste or failure of control can be an important safeguard. Such arrangements must be properly publicised and provide for sensitive handling of the subject area. The Public Interest Disclosure Act 1998 gives statutory protection to employees against unjust recrimination and unfair dismissal arising from such whistle-blowing.
- 74.** It may be possible to justify a course of action by citing a worthy motive, while the real underlying agenda is less than worthy in intent. A hidden agenda may lead to the avoidance of due process, such as unwarranted single tendering. As the boundaries between pragmatism, lack of

professionalism and impropriety are difficult to define and hard to prove, it is important to maintain effective controls and governance arrangements across the areas of particular risk within an organisation, such as at the interface between individual groups, paid officials and elected representatives.

Appropriate governance arrangements

75. Governance can be defined as the systems and frameworks by which organisations are directed and controlled ². In effect it is concerned with standards, systems, processes, controls, accountabilities and decision making at the heart of, and at the highest level of, an organisation.

76. Effective corporate governance is likely to include:

- ◆ checks and balances at a senior level so no individual enjoys unfettered discretion;
- ◆ systems of management and financial control;
- ◆ an internal audit function (or the regular review of the need for such a function);
- ◆ an audit committee, or its equivalent;
- ◆ a remuneration or awards committee;
- ◆ a formal scheme of delegated authority;
- ◆ a schedule of decisions which are reserved to the board.

77. Clearly, a system of corporate governance has much wider objectives than the prevention of failures of propriety. Nevertheless, the existence of an effective system, and in particular the establishment of clearly defined procedures, financial regulations and internal audit can provide powerful safeguards against failures of propriety. The particular areas where it is appropriate to establish procedures, regulations and controls are set out in the checklist in box 8.

Codes of conduct

78. The Nolan Committee has stated:

"The gravest concerns about standards of propriety focus on the misuse of public office to pursue personal interest. Directing contracts, business or expenditure towards organisations with which members of staff have a personal or financial connection is a particularly acute and widespread concern... However, impropriety can also arise out of ignorance of the rules, uncertainty about what the rules are, or a desire to get things done quickly even if it means bending the rules or cutting corners."

² Cadbury Report "The Report of the Committee on the Financial Aspects of Corporate Governance"

Box 8: Illustrative checklist of detailed controls

Pecuniary and political interests of board, elected members and employees

- ◆ all significant interests to be disclosed at least annually and immediately when they change or when there is an involvement in decisions affected by those interests;
- ◆ register of interests to be maintained, kept up to date and regularly reviewed;
- ◆ persons not to take part in decision making that affects, or is affected by, their interests (relevant experience may justify a contribution to discussions, but the interest must be declared and a clear procedure should be in place to determine whether such a contribution is justifiable).

Award of contracts

- ◆ specified minimum number of tenders for all major contracts;
- ◆ procedures for proper justification and scrutiny of any single tenders;
- ◆ controls over opening of tenders;
- ◆ proper arrangements for evaluating tenders;
- ◆ written report required on reasons for accepting tenders other than the lowest acceptable or best value.

Hospitality

- ◆ hospitality only to be accepted if representation appropriate;
- ◆ guidance available on levels of appropriate hospitality;
- ◆ register of gifts or hospitality to be maintained.

Disposals of property

- ◆ clear procedural guidelines to be established;
- ◆ all sales to require valuation and to be subject to tender process (or other process to ensure best value);
- ◆ board approval required for major sales.

Appointment of board members and senior staff

- ◆ selection panel set up for senior staff;
- ◆ requirement to disclose any relationships with candidates;
- ◆ checks to ensure that senior appointments conform to requirements that apply to other appointments, such as, equal opportunities arrangements.

Relocation and travel expenses

- ◆ clear guidelines issued on entitlements;
- ◆ specific criteria for approving and for incurring overseas trips (and rules for accompaniment by a friend or family member);
- ◆ independent approval required.

Stewardship

- ◆ Standing Orders and Standing Financial Instructions that incorporate delegated authority and limits of approval;
- ◆ budgetary control and monitoring;
- ◆ asset registers.

- 79.** The clearer it is that standards of conduct expected of public servants are understood the better the promotion of probity in public bodies. And the greater the prevalence and depth of understanding of such standards, the better the safeguard against impropriety arising out of a confusion over responsibilities. The boards of public bodies are expected to establish codes of conduct defining the standards of behaviour to which board members and employees are required to subscribe. In setting these codes of conduct, models of best practice have been developed, such as the *Treasury's Code of Conduct for Board Members of Public Bodies* and the *NHS Executive's Code of Conduct/Code of Accountability*.
- 80.** The presence of a code of conduct clearly demonstrates the importance placed on the standards of staff within the organisation. Important elements expected within a code are:
- ◆ outlines of expected professional and personal behaviour;
 - ◆ defined restrictions on business and political activities (where appropriate);
 - ◆ criteria and procedures for declarations of interests, both business and political;
 - ◆ definitions of conflicts of interest;
 - ◆ a statement of the aims and values of the body;
 - ◆ statements of the obligations of the body towards its customers, staff, community and other interested parties;
 - ◆ information about the body's approach to openness and arrangements for acquiring information about its activities;
 - ◆ procedures for raising complaints with an independent body;
 - ◆ definition of the dividing line between the role and responsibilities of the governing body and those of the executive staff.
- 81.** Promulgation and training are also important to ensure that codes and standards are understood. While people recruited from outside the public sector to run public bodies can bring with them fresh ideas and valuable skills, they may not have an immediate understanding of public sector practices and why such importance is attached to the use of proper procedures when dealing with public money. The Nolan report recommended that training should start before such candidates are selected by holding briefing sessions for potential candidates to ensure they are well aware of the roles they would be asked to assume.

Small organisations

- 82.** Small organisations, such as certain non-departmental public bodies and third tier local authorities, are not exempt from needing to have safeguards against impropriety. But the scale of the measures will be more modest. For example, rather than having an in-house internal audit service, the body will regularly review the need to contract for internal audit services on a limited period basis.

External safeguards against impropriety

- 83.** In addition to the steps each organisation can take for itself to safeguard against impropriety, external supervision provides further controls. External supervision comes from two main sources: monitoring by supervisory bodies, such as parent departments, and examination by external audit.

- 84.** Supervisory bodies may have roles in both establishing corporate governance arrangements and in scrutinising the operation of internal safeguards. For example, the NHS Executive, which oversees NHS bodies such as health authorities, issues guidance that determines the shape of safeguards against impropriety in NHS bodies. NHS Executive Regional Offices will also call individual NHS bodies to account for the implementation of such guidance.

- 85.** The safeguard provided by external audit concerns the scrutiny of the controls and systems that are in place. The next section of this paper explores the role that audit has to play and the approach that auditors take in their work to address propriety.

Propriety and Audit

Independent Scrutiny

- 86.** Public audit plays an important role in ensuring that those responsible for handling public money are held accountable for its use, through intermediary bodies and ultimately to Parliament and/or the public. Propriety is one part of public auditors'³ range of responsibilities, which include the audit of financial statements, issues of regularity and 'value for money'. The Auditing Practices Board notes the role of public sector auditors with regard to propriety in its revised Practice Note 10, *Audit of Financial Statements of Public Sector Entities in the United Kingdom*:

"Public sector auditors may also be required to...review and, where appropriate, to report on issues relating to standards of financial conduct in public bodies and aspects of the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs. In central government, the Comptroller and Auditor General has regard to and reports to Parliament on matters of propriety. The Auditor General for Wales, the Comptroller and Auditor General for Northern Ireland and the Auditor General for Scotland have a similar responsibility. In local government and the National Health Service in England and Wales public sector auditors' work on financial aspects of corporate governance also includes reviewing the arrangements set in place by the audited body in relation to the financial standing of the audited body, systems of internal financial control, and the prevention and detection of fraud and corruption."

(It should be noted that the practice note does not give guidance to auditors on any responsibilities regarding propriety.)

- 87.** Parliament maintains oversight of the use of public funds through the Comptroller and Auditor General (C&AG) who, assisted by the National Audit Office, is required to pay particular attention to issues of regularity and propriety. He also has a role in investigating and reporting on impropriety encompassing fraud, corruption and other forms of misconduct. Specifically, he is required to take into account proposals made by the Committee of Public Accounts for examinations of economy, efficiency and effectiveness (National Audit Act 1983 (Section 1(3))). Such proposals often include matters of propriety.
- 88.** Reports prepared by the C&AG are considered by the Committee of Public Accounts (PAC), who publish their own reports. The process of scrutiny by the PAC constitutes a significant deterrent against misconduct and acts as a powerful vehicle for promoting beneficial change in the management of public bodies. The Committee take a keen interest in ensuring appropriate disciplinary action has been taken against those responsible for misconduct and make it abundantly clear that the highest standards of conduct are expected in the public service.
- 89.** As a consequence of the Government's devolution legislation, there have been some changes in the structure of public audit. In Wales, the Auditor General for Wales (AGW) arranges with the

³ "Public auditors"...in the context of this paper, encompasses all auditors operating in the public sector whether public sector employees or members of audit firms in the private sector.

NAO to prepare reports for consideration by the Audit Committee of the National Assembly for Wales. The process is similar to scrutiny by the C&AG and PAC. The Government of Wales Act also provides for the C&AG and PAC to continue to take an interest in Welsh affairs and to request the Audit Committee to consider issues on behalf of the PAC. In Scotland, the Auditor General for Scotland (AGS) is supported by audit teams previously employed by the Accounts Commission and the National Audit Office. The Scottish Parliament has legislated that audit reports should include comments on compliance with relevant guidance and on propriety. The AGS' reports are considered by the Audit Committee of the Scottish Parliament. The reports of the Northern Ireland Comptroller and Auditor General are considered by the Public Accounts Committee of the Assembly.

- 90.** In the local government sector, auditors appointed by the Audit Commission and the Accounts Commission report on the financial statements of local authorities and conduct examinations into value for money, governance issues, and where indicated necessary, fraud and corruption. The same arrangements also apply in England with regard to the health sector, but in Scotland, the Auditor General for Scotland reports on NHS bodies.
- 91.** Appointed auditors have the power to publish reports directly where they believe these to be in the public interest. In the case of NHS bodies, which are in the first instance accountable to the Secretary of State, issues of impropriety and poor governance may also be brought to the attention of the Committee of Public Accounts through reports made by the Comptroller and Auditor General on the Department of Health.
- 92.** Section 91(6) of the Local Government Act 2000 requires auditors of local authorities in England and Wales to serve statements of reasons for their belief that an authority may have taken, or be about to take, a course of action which, if pursued to its conclusion, would be unlawful. Statements concerning potentially unlawful actions will often, of practical necessity, be supported by a specific review. Under the Audit Commission Act 1998, auditors have a duty to report to the Secretary of State if they have reason to believe that a health service body has made or is about to make decisions involving potentially unlawful expenditure, or has taken, or is about to take, a potentially unlawful action, likely to cause a loss or deficiency. This is, however, more likely to arise over questions of regularity rather than propriety.
- 93.** In other organisations, typically Non-Departmental Public Bodies (NDPBs) and government agencies, auditors may be required to report on specific aspects of activity covered by separate terms of engagement.
- 94.** Accountability is, among other things, a deterrent to impropriety. But as well as facilitating accountability, auditors themselves have a deterrent effect. This will, however, only be credible if the auditors themselves act with propriety and are rigorous in their approach.

Respective roles of auditors, boards and other governing bodies, and management with regard to propriety

- 95.** As noted in the previous section on safeguards against failures of propriety, the implementation of such safeguards is the responsibility of management. While public sector external auditors may have a duty to report on matters of propriety, as indicated in this section, this should not be confused with a duty to ensure propriety.

Audit work in general

- 96.** In all types of audit work, both financial and value for money, public sector external auditors aim to:
- ◆ provide independent assurance and where necessary information and advice to Parliament and/or the taxpayer, on the proper accounting for, and use of, public resources;
 - ◆ make a positive difference to the financial management and value for money achieved by public bodies.

Public sector internal auditors have similar aims, but their reporting is to management or the executive rather than to Parliament and the public.

- 97.** The auditor's role is therefore important to the effective delivery of public sector services and use of public funds. The importance of this role is illustrated by instances of experienced auditors being asked to provide advice to Chairmen and Audit Committees in difficult and sensitive circumstances, such as where there has been a breakdown in internal management control.
- 98.** Propriety is concerned with compliance with expectations of conduct and behaviour which although not written into legislation or regulations are generally accepted as being central to the management of public funds. As referred to in the foregoing section on definition, acts of impropriety will be concerned with specific misconduct, knowingly perpetrated for personal or political gain, and capable of being proven as any other offence. Similar acts, undertaken with a lack of knowledge and motivation are, on the other hand, omissions of propriety. The effects on an organisation are often the same, but the auditor may need to bear the distinction in mind in case he is called to act in a forensic capacity.
- 99.** Public sector auditors have a legitimate concern about propriety even though it may not be explicitly included in their terms of reference or operational standards. The scope of the work of auditors in relation to propriety needs to be considered from two viewpoints:

- ◆ in the context of a financial statements audit (paragraphs 103 to 109);
- ◆ as a specific review of an aspect, or aspects, of propriety carried out as part of a cyclical programme or for other reasons (paragraphs 111 to 124).

Regardless of the scope of audit work, the action where significant failures of propriety are suspected and the methods of reporting them are likely to be similar.

100. Whether an act constitutes improper behaviour within the generally accepted standards of conduct expected in public business is often a matter of interpretation. However, public sector auditors' training, experience and understanding of the general standards of conduct expected may enable them to recognise that some acts coming to their attention may constitute impropriety. The determination as to whether a particular act constitutes, or is likely to constitute, impropriety is generally based on the auditors experience and knowledge of:

- ◆ Parliamentary expectations of the way in which public business should be conducted, for example, in relation to those cases brought to public attention in reports by the Comptroller and Auditor General and the Public Accounts Committee (see box 4, paragraph 38);
- ◆ the requirements, in the cases of central government departments and executive agencies, of Government Accounting and other instructions to Accounting Officers by Treasury and Cabinet Office, including for example the checklist of potential compliance failures in the Committee of Public Accounts report on the Proper Conduct of Public Business (DAO (GEN) 3/94);
- ◆ Directions, by the Secretary of State to non-departmental bodies, to operate within a framework of regulation including the body's financial memorandum, Government Accounting, Government Internal Audit Manual and any other guidance issued by the department;
- ◆ the basic expectations of the public auditor of local authorities and health entities as set out in the codes of audit practice issued by the Audit and Accounts Commissions and other guidance issued by these bodies, as well as codes of conduct issued by relevant departments and by the organisations themselves.

101. In local government, in particular, there is a substantial body of legislation and case law that can be used to determine whether particular activities constitute, or are likely to constitute, impropriety. The annex gives an outline of relevant legislation, but up to date standard references should be consulted for case law.

The Role of Internal Audit

102. Internal audit has its own part to play in the scrutiny function. Apart from its role as a component in the internal control environment, it can act as a body's own conscience on matters of propriety. The Auditing Practices Board internal audit guideline sets out the importance of internal audit's freedom of access and reporting to all senior management and the board.⁴ This provides a crucial mechanism for challenging the actions of senior officers and members. Internal audit's focus on risk and internal controls and detailed knowledge of its client body places it in a powerful position to detect issues of propriety. Close liaison with a body's internal audit is therefore likely to greatly help external auditors undertaking a review of propriety to achieve a thorough understanding of the business.

Propriety in the context of the financial statements audit

103. Propriety is outside the scope of the auditors' opinion on the financial statements of public entities. In their planning of the financial statements audit, public sector auditors do not plan and perform their work in order to identify possible instances of impropriety, other than where fraud may cause the financial statements to contain material mis-statements.

104. While external auditors of public bodies are not required to perform specific procedures for the purpose of identifying improprieties as part of the examination of the financial statements, they remain alert for instances of significant possible or actual non-compliance with general standards of public conduct. In particular, auditors may develop a general appreciation of the framework of governance and standards of conduct within which the entity conducts its activities from their work to gain an understanding of the overall control environment. This can be an important potential source of information on any impropriety.

105. Such work on the overall control environment is governed by the Statement of Auditing Standard 300, Accounting and Internal Control Systems and Audit Risk Assessments (SAS 300). This requires auditors to assess inherent risk, taking account of factors relevant to the entity as a whole. Although not specified in SAS 300, to obtain information on such factors, external auditors may:

- ◆ familiarise themselves with the general regulations, rules and other guidance relating to the conduct of the organisation's business;
- ◆ enquire of management concerning the entity's policies and procedures regarding the implementation of codes and instructions, while having regard to whether the policies and procedures are comprehensive and up to date;

⁴ The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom provides a useful public sector interpretation of the APB Guideline.

- ◆ discuss with management and internal auditors the policies or procedures adopted for promulgating and monitoring compliance with relevant codes and instructions.

106. Other procedures that may bring such impropriety to the auditors' attention include:

- ◆ reading minutes of board and management meetings to pick up on those matters arising from the ongoing review of the board and other committees;
- ◆ assessing the entity's control environment, particularly the absence of policies and procedures in relation to areas where there are significant risks of fraud, corruption or other impropriety;
- ◆ reviewing the results of internal audit examinations;
- ◆ performing substantive tests of details of transactions or balances.

107. In addition to evidence obtained in the course of the financial statements audit, specific information that indicates new areas of risk to propriety may come from press and Parliamentary comment, letters from MPs, councillors or members of the public, or other sources. Where audit staff draw such matters to the attention of the senior auditor responsible for the engagement he may decide whether or not to undertake a specific examination of propriety.

108. Where specific weaknesses are revealed in the course of enquiry and discussion, it is appropriate to report these to management and to consider their impact on audit risk. (Auditors will note that SAS 300 relates to obtaining an understanding of the accounting and internal control systems sufficient to plan audits for the purpose of providing an opinion on financial statements. It is not, therefore, a reference for reporting on propriety.)

109. Evidence on propriety may emerge after the financial statements have been signed. The auditor will consider whether such evidence requires adjustment of, or disclosure in, the financial statements. In cases where there is an impact on the financial statements, which is most likely in the case of fraud, the auditor will be guided by Statement of Auditing Standard 150, *Subsequent Events*, and by the Practice Note *Audit of Financial Statements of Public Sector Entities in the United Kingdom*.

110. There are a number of factors that significantly limit the extent to which a financial statements audit can be expected to identify impropriety, including:

- ◆ the differing concepts of what propriety means;
- ◆ evidence as to the way that business is conducted will often not be recorded;
- ◆ the fact that impropriety often involves concealment and collusion;
- ◆ the monetary value of transactions affected by propriety issues may often be small and so stand less chance of being identified through audit processes of testing.

This also means that subsequent discovery of impropriety does not necessarily indicate an inadequate audit.

Propriety as a specific review

- 111.** The extent of any external review of specific aspects or areas related to propriety will depend on the statutory requirements of the particular part of the public sector or on the terms of any specific commission. Paragraphs 87 to 92 illustrate the range of statutory requirements.
- 112.** Specific commissions for reviews of propriety can be instigated by a variety of parties, including, a Secretary of State, sponsoring department, officials, audit committee and representatives of concerned citizens. In these cases, the extent of audit review will be determined by agreement with the commissioner of the work.
- 113.** The extent of internal audit review depends partly on the assessment of relative risk and priority arrived at by the internal audit function's own planning procedures, and partly on any specific commission agreed with the organisation's senior management. The internal audit function's own planning procedures are likely to:
- ◆ identify and evaluate risks to the organisation in terms of propriety;
 - ◆ take account of known strengths and weaknesses in the internal control systems with regard to propriety;
 - ◆ take account of management concerns and expectations with regard to propriety;
 - ◆ take account of the plans of external auditors with regard to any review of propriety.
- 114.** There are several approaches to specific reviews, whether internal or external, including:
- ◆ a retrospective review to confirm propriety and/or inform due process for similar transactions in the future;
 - ◆ a retrospective review to investigate concerns about impropriety;
 - ◆ a real time review to confirm propriety and adequate safeguards.
- 115.** There are two possible aims of such reviews:
- ◆ to provide assurance that adequate controls exist to prevent failures of propriety. In this instance, the review remit might extend to testing the operation of such controls;
 - ◆ to detect, or examine, instances of significant failures of propriety.

The latter is likely to have most ongoing value if it also addresses whether there are suitable systems in place to safeguard against impropriety. Where such systems are inadequate, it should also indicate remedial changes. Reviews of propriety matters are not a substitute for internal controls and governance arrangements. They are therefore of most benefit when they are system oriented rather than directed at detecting individual instances of impropriety across an organisation.

- 116.** The test of 'significance' is different from that of 'materiality', and this is a key distinction between financial statements audit and reviews of propriety. Significance in the context of impropriety goes beyond the concept of materiality used in auditing and expressing an opinion on the financial statements because it includes qualitative factors that may not be relevant in the context of the financial statements. It also embraces non-financial as well as financial matters.
- 117.** Unlike materiality, which has both quantitative and qualitative elements, significance is an almost entirely qualitative concept. A significant matter would be one that the public auditor knows from experience and training that the appropriate Parliament or Assembly, Accounting Officer or the taxpayer would be interested in and which they would report in the public interest even where they did not qualify the opinion on the financial statements. Examples of such matters are included in the section on failures of propriety (paragraphs 53 to 55), and an understanding of Parliament's concerns can be gained from box 4 (paragraph 38).
- 118.** The scope and depth of coverage of a review depends on the auditor's judgement of what is necessary to fulfil any statutory or agreed requirements, taking into account the significance of the risks identified, the extent and nature of the financial statements audit and the extent and quality of other auditor's work (external auditors and/or internal auditors, depending on the situation). In this regard, it should be emphasised that it is the responsibility of management of the audited body to identify, assess and manage risks of failures of propriety.
- 119.** To develop an efficient and effective programme of review of propriety, public sector auditors need a thorough understanding of the client and its business. If the auditors undertaking a review of propriety are not also the auditors of the financial statements, they will normally liaise closely with those financial auditors as the knowledge gained in both planning and conducting the annual financial statements audit provides a basis for developing the programme of propriety reviews. The review of the financial control environment, the testing of transactions and controls and discussion with client staff all provide information on the nature and extent of risks within the client.
- 120.** While the institution of an external review of propriety results from either a statutory duty or a commission, such as a request of management or audit committee, the responsibility for designing a programme of work rests with the auditor. Programmes are likely to aim at examining and, if necessary, reporting on the potentially significant risks that the auditor can reasonably identify or are brought to his attention. Auditors will be guided by various factors in determining which areas to cover, whether as part of a cyclical programme or dealing with specific targeted reviews. These include:

- ◆ indications of problems from internal sources - management and internal audit - and external sources, such as press and information from the public;
- ◆ matters arising from previous audit reports;
- ◆ particularly high level of activity in the area concerned, for example, letting of contracts;
- ◆ matters arising from the review of minutes;
- ◆ areas not reviewed for a number of years.

I21. Auditors may develop a medium term plan to address all areas subject to risk of failure of propriety over a period of years, which will be reviewed annually to determine the actual area or areas to be covered in the year and linked with internal audit's programme. The areas likely to be included in a medium-term programme include:

- ◆ pecuniary interests of board and elected members and staff;
- ◆ tendering and award of contracts;
- ◆ disposal of property and other assets;
- ◆ acceptance of hospitality;
- ◆ appointment of board members and senior staff;
- ◆ award of planning consents and licences;
- ◆ arrangements for whistle-blowing;
- ◆ relocation and travel expenses of board members and senior staff.

I22. The scope of work and the procedures to be followed will vary widely depending on the aim of the review, the number of transactions and the proposed form of output. Although issued by the Auditing Practices Board as standards for the audit of financial statement, and for no other purpose, auditors may draw upon the auditing standards in planning, controlling, documenting and obtaining evidence for their work on propriety. In deciding what evidence is required it is important to remember at all times that public sector auditors will normally be reporting in some detail to the client or in public. As a result, the public auditor's methods and the sufficiency and appropriateness of evidence and findings will be open to challenge. At the same time, public sector auditors will inevitably be working within tight resource constraints. The auditor will therefore need to ensure that his methods not only lead to defensible evidence, but are also defensible in themselves. The auditor will need to use his judgement of the situation so as to undertake sufficient evidence gathering to meet the expectations of his client or Parliament but not so much as to 'over-audit' the body.

- 123.** As with other audit work, a key factor in ensuring that the auditor's work to gather evidence for review of propriety is sufficient is close liaison with other parties that may be undertaking such work. The importance of liaison between external and internal audit has already been underlined at paragraph 102. Other relevant parties include, for example, in the NHS, the Directorate of Counter-Fraud Services, for which there is a memorandum of understanding for co-operation with auditors (HSC 1999/181). Such liaison will help ensure the avoidance of unnecessary duplication.
- 124.** Where there are no express provisions covering consultation in an auditor's terms of engagement, it is expected, as a matter of courtesy, that public sector auditors will normally discuss plans for audits of propriety with the audited body and explain both why and how they are doing the work. In exceptional circumstances, this may be inappropriate; any decision not to consult is most appropriately made by the senior auditor responsible.

Procedures when possible impropriety is discovered

- 125.** When public sector auditors become aware of evidence of failure of propriety, they aim to obtain an understanding of the nature of the act and the circumstances in which it has occurred and sufficient additional information to evaluate the possible impropriety. If public sector auditors consider that the impropriety could be significant, they may perform appropriate additional procedures and document the results carefully.
- 126.** The extent of additional procedures the public sector auditor decides to perform in response to impropriety is a matter of judgement, and depends on:
- ◆ the nature of the impropriety;
 - ◆ the persons involved;
 - ◆ the impact on the financial statements;
 - ◆ the likelihood that the impropriety may have led to a loss of public funds;
 - ◆ the likelihood that the suspected impropriety involves fraud;
 - ◆ the extent to which the issue is being investigated, and dealt with, by the audited body;
 - ◆ the extent to which further procedures can be expected to clarify the situation;
 - ◆ the extent to which the impropriety indicates that other impropriety or mis-management may be present;
 - ◆ the likelihood of the need to report in the public interest.

- 127.** Documenting such work may include making minutes of conversations as well as taking copies of relevant records and documents.
- 128.** Where there is suspicion of impropriety but an absence of evidence, the auditor may consider drawing management's attention to the possibility of introducing procedures that would generate evidence were the suspicion to be well founded. In much the same way as with suspected fraud, the auditor will need to proceed cautiously so as to avoid false allegations or breaches of the Human Rights Act 1998.
- 129.** At the earliest suitable opportunity, the auditors discuss their findings with an appropriate level of management whom they do not suspect of involvement with the impropriety. If the body has an audit committee, it is likely that it would be appropriate for the auditor to discuss their findings with them. In some cases, where senior staff or board members are involved, it may be necessary to raise the matter with the Accounting Officer or the appropriate sponsoring government department.
- 130.** If the auditors consider that impropriety may have, or has, occurred, they may need to reconsider their assessments of audit risk and the validity of management representations. For example, a series of suspected or actual instances of impropriety that are not significant financially may be symptomatic of management's general disregard for proper conduct and hence may throw doubt on the integrity of management generally.

Reporting on the audit of propriety

- 131.** The method of reporting on audit work relating to propriety will vary depending on the nature of the work undertaken and its results. The results of propriety audit will normally be communicated to management in client bodies either by way of letter or management report. Such communications will be aimed at clearly setting out the scope of audit work and its findings and offering constructive advice on how risks can be reduced and improvements made in controls. It is important that the auditors make the scope of their work quite clear, avoiding blanket assurances that cannot be supported. The summarised results of such work, whether negative or positive, would be included in a management letter to the board or audit committee.
- 132.** Where auditors become aware of a significant failure of propriety they may have a duty to report "in the public interest" either to the appropriate Parliament or Assembly or to the public. The report may either be issued in connection with the report on the financial statements or issued separately, depending on the financial consequences of the failure of propriety and the timing of the finding.
- 133.** In certain sectors, there are particular reporting requirements when impropriety is an issue. Auditors of local authorities in England and Wales, and the Controller of Audit in Scotland, have

particular reporting duties on matters of impropriety, including the issuing of advisory notices which enable the clarification of the legality of authorities' actions.⁵

134. 'Public interest' is a concept that is not capable of general definition and each situation must be considered individually. Matters to be taken into account when considering whether reporting is justified in the public interest may include:

- ◆ the extent to which the suspected or actual failure of propriety is likely to affect members of the public; for example the inadequate stewardship of public assets leading to financial loss;
- ◆ whether management have rectified the matter or are taking, or are likely to take, effective corrective action;
- ◆ the gravity of the matter;
- ◆ whether there is a general management ethos within the entity of disregarding propriety;
- ◆ whether the issue of a report would undermine public confidence in the authority unnecessarily.

⁵ The Local Government Act 2000 repeals:

- ◆ auditors' powers under section 18 of the Act, so that they would no longer have a judicial function of certifying losses caused by wilful misconduct;
- ◆ the power of the courts to order repayment of unlawful expenditure (under section 17 of the Act), but not auditors' power to apply to the courts for a declaration that an item of account is unlawful;
- ◆ auditors' power to issue a prohibition order to a local government body (under section 20 of the Act);
- ◆ recent Scottish legislation abolishes the surcharge function in Scotland.

Appendix

Sources of Guidance

- A Central Government
- B Devolved Government
- C Health
- D Local Government
- E Education

A Central Government

Cabinet Office (<http://www.cabinet-office.gov.uk/>)

Civil Service Management Code (Cabinet Office, March 1996)

1. The *Civil Service Management Code* sets out regulations and instructions to departments and agencies regarding the terms and conditions of service of civil servants. It also sets out regulations, instructions and conditions regarding the delegations, which have been made by the Minister for the Civil Service under the Civil Service (Management Functions) Act 1992, to Ministers and the office holders in charge of departments. Where departments and agencies are given discretion to determine terms and conditions, the Code sets out the rules and principles that must be adhered to in the exercise of that discretion. It includes guidance on conduct and discipline, including the *Civil Service Code* and the *Standards of Propriety*.

Civil Service Code

2. The *Civil Service Code* encompasses the principles of integrity, honesty, loyalty, accountability, fairness, compliance, impartiality and objectivity to assist the duly constituted Government. It states that civil servants should deal with the affairs of the public sympathetically, efficiently, promptly and without bias or maladministration and should endeavour to ensure the proper, effective and efficient use of public money and retain the confidence of Ministers.
3. The Code stresses that civil servants should not misuse their official position or information acquired in the course of their official duties or receive benefits of any kind that might be seen to compromise their personal judgement or integrity. Similarly, they must not disclose official confidential information. But the Code does not override existing statutory or common law obligations to keep confidential, or to disclose, certain information.
4. The *Civil Service Code* also outlines how individuals can report instances where they believe they are being required to act in a way that is illegal or improper or unethical, is in breach of constitutional convention or a professional code, may involve possible maladministration, or is otherwise inconsistent with the Code. Detailed procedures for reporting such matters are set down in departmental guidance or rules of conduct. The final recourse for reporting impropriety is to report the matter in writing to the Civil Service Commissioners.

Standards of Propriety

5. The *Standards of Propriety* set down rules for departments and agencies on a range of matters, including:
 - ◆ letting of contracts to civil servants and the requirement for staff to report relevant business interests;
 - ◆ sale of surplus Government property to civil servants;
 - ◆ requirements on staff to seek permission before accepting outside employment;
 - ◆ circumstances where staff are required to report offers of gifts, hospitality, awards, decorations or other benefits;
 - ◆ the employment of bankrupt or insolvent civil servants on duties which might permit misappropriation of funds.

Codes of Practice for Board Members of Public Bodies (Cabinet Office, January 1997)

6. The Cabinet Office issued new guidance, *Codes of Practice for Board Members of Public Bodies*, to take account of the recommendations of the First Report of the Nolan Committee, the Government's response and subsequent consultation papers to that report.⁶ The model code of practice for board members of executive non-departmental public bodies (NDPBs) and similar organisations is intended to provide a framework that the public bodies concerned should use - with any modifications that may be necessary and are agreed with the sponsor department - to take account of their own characteristics and circumstances. This guidance covers public service values, relationship with the sponsoring department, the role of the chairman, the corporate responsibilities of board members, strategic planning and control, delegation, responsibilities of individual board members, handling conflicts of interest, personal liability of board members, openness and responsiveness, accountability for public funds, annual reports and accounts, the role of the chief executive, audit committees, and the board as employer.

Model Code for Staff of Executive Non-Departmental Public Bodies (Cabinet Office, August 1996)

7. The Cabinet Office have also prepared the *Model Code for Staff of Executive Non-Departmental Bodies* in response to the Nolan Committee's recommendations that it should be mandatory for the board of each executive NDPB to adopt a code of conduct. The model code provides a framework for NDPB's and similar bodies to adopt with any modifications that may be necessary to take account of their own characteristics and circumstances. It encompasses the duties and responsibilities of staff, accountability, conflicts of interest, integrity, relations with the public, use of resources, confidentiality, staff concerns about improper conduct and obligations after leaving employment.

⁶ "Spending Public Money: Governance and Audit Issues", Cm 3179

Ministerial Code

8. The Prime Minister issued a revised version of this code in July 2001. It sets out the arrangements for the conduct of affairs by Ministers and states:

"Ministers of the Crown are expected to behave according to the highest standards of constitutional and personal conduct in the performance of their duties.

"This Code provides guidance to Ministers on how they should act and arrange their affairs in order to uphold these standards. It lists the principles which may apply in particular situations drawing on past precedent. It applies to all members of the Government (and covers Parliamentary Private Secretaries in section 4).

"Ministers are personally responsible for deciding how to act and conduct themselves in the light of the Code and for justifying their actions and conduct in Parliament. The Code is not a rulebook, and it is not the role of the Secretary of the Cabinet or other officials to enforce it or to investigate Ministers although they may provide Ministers with private advice on matters which it covers.

"Ministers only remain in office for so long as they retain the confidence of the Prime Minister. He is the ultimate judge of the standards of behaviour expected of a Minister and the appropriate consequences of a breach of those standards, although he will not expect to comment on every allegation that is brought to his attention.

"The Code should be read against the background of the overarching duty on Ministers to comply with the law, including international law and treaty obligations, to uphold the administration of justice and to protect the integrity of public life. They are expected to observe the Seven Principles of Public Life set out in the first report of the Nolan Committee...and the following principles of Ministerial conduct:

- i. Ministers must uphold the principle of collective responsibility;*
- ii. Ministers have a duty to Parliament to account, and be held to account, for the policies, decisions and actions of their departments and 'next steps' agencies;*
- iii. it is of paramount importance that Ministers give accurate and truthful information to Parliament, correcting any inadvertent error at the earliest opportunity. Ministers who knowingly mislead Parliament will be expected to offer their resignation to the Prime Minister;*
- iv. Ministers should be as open as possible with Parliament and the public, refusing to provide information only when disclosure would not be in the public interest which should be decided in accordance with the relevant statutes and the Government's Code of Practice on Access to Government Information;*
- v. Ministers should similarly require civil servants who give evidence before Parliamentary Committees on their behalf and under their direction to be as helpful as possible in providing accurate, truthful and full information in accordance with the duties and responsibilities of civil*

servants as set out in the Civil Service Code;

- vi. Ministers must ensure that no conflict arises, or appears to arise, between their public duties and their private interests;*
- vii. Ministers should avoid accepting any gift or hospitality which might, or might reasonably appear to, compromise their judgement or place them under an improper obligation;*
- viii. Ministers in the House of Commons must keep separate their roles as Minister and constituency Member;*
- ix. Ministers must not use government resources for Party political purposes. They must uphold the political impartiality of the Civil Service and not ask civil servants to act in any way which would conflict with the Civil Service Code."*

Guidance on Guidance : An Index to Useful Documents (Cabinet Office, February 1996)

- 9.** The Cabinet Offices booklet *Guidance on Guidance* provides a summary of central guidance on a wide range of topics including conduct and propriety.

HM Treasury (<http://www.hm-treasury.gov.uk/>)

Government Accounting

- 10.** *Government Accounting* is issued by the Treasury. It sets out the arrangements for accounting to Parliament for public funds and the requirements for Parliamentary and Treasury approval of expenditure. It lays down guidance on the general responsibilities of an Accounting Officer (the Accounting Officer memorandum), which includes the requirement to:

"... ensure there is a high standard of financial management in the organisation; that financial systems and procedures promote the efficient and economical conduct of business and safeguard financial propriety and regularity throughout the department; and that financial considerations are fully taken into account in decisions on policy proposals."

"An Accounting Officer has particular responsibility to see that appropriate advice is tendered to Ministers on all matters of financial propriety and regularity"

- 11.** It also lays down requirements in terms of accountability in non-departmental public bodies:

"Sponsor departments have a duty to ensure that the financial and other management controls to be applied by their NDPBs are appropriate and sufficient to safeguard public funds and comply with the requirements of regularity and propriety and that these bodies conduct their operations as economically, efficiently and effectively as possible." Additionally:

"The NDPB accounting officer, as Chief Executive, has responsibility for propriety in the broad sense, including conduct and discipline. This stems from the responsibility for the overall organisation, management and staffing of the NDPB and for its procedures in financial and other matters."

DAO letters

12. Dear Accounting Officer (DAO) letters are issued by the Treasury Officer of Accounts. They provide guidance on a range of issues that includes accounting and control issues, and conclusions of general application emerging from PAC inquiries. DAO letters that are particularly relevant to the consideration of propriety include:

- ◆ Checklist of Points in the PAC's Eighth Report on the Proper Conduct of Public Business, DAO(Gen) 3/94;
- ◆ Public Accounts Committee: Conclusions of General Application, DAO(Gen) 6/94, DAO(Gen) 4/95, DAO(Gen) 10/96, DAO(Gen) 1/97 and DAO(Gen) 11/97;
- ◆ Disposal of Land and Buildings and Other Land Transactions by Government Departments and Non-Departmental Public Bodies, DAO(Gen) 11/96;
- ◆ Estates and Building Services Procurement: Prevention of Fraud and Irregularity in the Award and Management of Contracts, DAO(Gen) 17/96; and
- ◆ Corporate Governance: Statement on the System of Financial Control, DAO(Gen) 4/99.

Regularity and Propriety Handbook (HM Treasury, July 1997)

13. The Treasury's Regularity and Propriety handbook is designed for Accounting Officers and others in public bodies who have an important role in ensuring regularity and propriety. Its aim is to illustrate what is and is not 'proper' behaviour in the stewardship of public funds. It suggests that there is one final test to apply if there is a question mark over whether a proposed course of action meets the requirements of propriety:

Could I satisfactorily defend this course of action in public?

It also sets out some basic "do's and don'ts" of public servants:

- ◆ don't bend or break the rules;
- ◆ put in place and follow clear procedures;
- ◆ if approval is needed, get it first;
- ◆ don't allow a conflict of interest to affect, or appear to affect, decisions;

- ◆ don't use public money for private benefit;
- ◆ be even-headed;
- ◆ record the reasons for decisions.

Managing the Risk of Fraud - A Guide for Managers (HM Treasury, December 1997)

- 14.** The Treasury's guidance, *Managing the Risk of Fraud*, outlines the fraud risks in public bodies that may require specific control measures. The first part of the guide outlines how senior managers can promote an appropriate anti-fraud culture and establish appropriate fraud policy statements and fraud response plans. The second part of the guide provides practical guidance for line managers on fraud prevention and detection, fraud risks in specific areas, fraud investigation and fraud reporting.

Procurement Guidance

- 15.** HM Treasury's Procurement Group (formerly the Central Unit on Procurement) are responsible for issuing guidance on purchasing and supply procedures and practices. This includes guidance on the application of European Commission procurement directives as implemented in UK legislation. The Group has issued a series of notes which provide detailed guidance on all aspects of the procurement process.

Guidance Note no. 55: Ethics in Procurement (HM Treasury, May 1997)

- 16.** This note sets out:

- ◆ the basic rules of ethical conduct in procurement;
- ◆ the responsibilities of staff and managers;
- ◆ advice on appropriate systems and procedures supporting ethical behaviour;
- ◆ the legal framework (including that relating to the acceptance of gifts and hospitality).

B Devolved Government

- 1.** The Government's devolution legislation enables Wales, Scotland and Northern Ireland to establish their own guidance on propriety. However, the disciplines required and the principles adopted are essentially the same.
- 2.** In Wales, the National Assembly has adopted standing orders and codes of conduct based on Nolan principles. It has also introduced a finance handbook focusing on the key elements of financial control and conduct of public business and enabling Assembly members and officials to identify further sources of information.
- 3.** In Scotland, the Parliament has codes of conduct based on Nolan principles. The Executive is issuing guidance to its staff on propriety and financial management generally.

C Health

(<http://www.doh.gov.uk/publications/coinh.html>)

1. For the health sector in England and Wales, the over-arching governance arrangements are set out in the National Health Service Act 1977, the National Health Service and Community Care Act 1990 and the Health Act 1999. The legislation sets out the constitution and responsibilities of local health bodies - health authorities, NHS Trusts, Primary Care Trusts and Primary Care Groups - and establishes their relationship with the Secretary of State.
2. Below the statutory level, the senior officers of local health bodies are formally designated as either "accountable officers" (health authorities and NHS Trusts) or "responsible officers" (Primary Care Groups) with specific responsibilities for propriety.
3. The framework is underpinned by *Codes of Conduct and Accountability* issued in 1994 and the requirement placed on all health bodies to adopt Standing Financial Instructions ("SFI's"). Standing Orders and Schemes of Delegation are based upon models issued by the NHS Executive. In practice, SFI's are included in the minimum control standards for NHS Trusts. And each year the accounts of all health bodies must include a statement on internal financial control.
4. There are three crucial aspects of encouraging best practice in Governance in the NHS that are relevant to this guidance:
 - ◆ **Frameworks of Accountability** - Accountability both locally and nationally is the main driver for governance. The accountability of boards and individuals is set out in detail in the NHS codes. The designation of chief executives as 'Accountable Officers' in 1995⁷ was a major step forward in terms of establishing clear lines of responsibility within a devolved service.
 - ◆ **Introduction of Audit Committees** - Audit Committees were established in 1994 incorporating non-executive directors. The *Audit Committee Handbook* issued by the NHS Executive in September 1995⁸ together with Appendix A to the *Code of Conduct and Accountability* sets out the role of the committee in some detail. Linked to this has been emphasis on developing a strong and professional internal audit service.
 - ◆ **The Controls Assurance Project** - This project is about the practicality of rationalising and completing the control framework, integrating functions and involving people widely in the process. The project has emerged as a result of three issues: the need for a resilient integrated and comprehensive system of risk management and control to offset the complexity of the NHS; the need for openness to demonstrate best practice in governance to the population at large, and the intractable frailty element of human behaviour. HSC 1999/123 Governance in the new NHS requires NHS trusts and health authorities to ensure that appropriate structures are in place for implementing a controls assurance framework. This includes the production of a controls assurance statement in respect of financial and non-financial controls. It should be noted that the framework is being extended to include non-financial controls.

⁷ Accountable Officer Memorandum for Chief Executives of NHS Trusts 20 March 1995

⁸ Corporate Governance in the NHS: Audit Committee Handbook 28 September 1995

5. Developments in the structure of the NHS mean that the roles of certain NHS personnel are changing. In particular, the accountability of general practitioners is changing with the creation of Primary Care Trusts. The expectation that general practitioners will uphold public sector values is becoming more prominent.
6. Other NHS guidance relevant to propriety includes:
 - ◆ NHS Code of Openness;
 - ◆ Accountable Officer memoranda;
 - ◆ guidance on disclosure of related party transactions in the annual accounts.
7. The NHS in Scotland has the *Code of Conduct for Board Members of NHS Bodies*⁹. This code places public service values at the heart of the National Health Service. Three public service values are included: accountability, probity and openness. The Code covers the recognised issues of hospitality, handling business relationships, staff and regularity. In the area of accountability, the Code outlines the status of NHS Boards, roles and duties of NHS boards and reference to reporting and controls set out in financial guidance and standing orders.
8. In 1998, the Welsh Office Health Department (now part of the National Assembly for Wales) issued the *Corporate Governance Framework for Wales*. This was addressed to Chairmen and Board members of Wales' NHS trusts, health authorities and special health authorities. It sets the tone early on by way of reference to the public service values of accountability, probity and openness, as well as Nolan's seven Principles of Public Life. This followed on from detailed guidance¹⁰ on the implementation of the *Code of Conduct and Accountability* issued in 1995.
9. In the health sector, each board operates within a statutory framework within which it is required to adopt Standing Orders issued by the Secretary of State (*Ministerial Directions*). The *Directions on Financial Management in England*, issued under HSG(96)12 in 1996, states that each board must adopt Standing Financial Instructions (SFIs) setting out the responsibilities of individuals. These Directions are mandatory for health authorities but not for NHS trusts. NHS trusts are asked to observe the Directions as far as they are relevant as a matter of good practice. The models provide an appropriate checklist of the main matters that should be considered for inclusion by all health organisations in their own SFIs.
10. There are also model schemes of delegation and reservation of powers to the board that set the scope of operation of the board.

⁹ The NHS in Scotland - Corporate Governance: Code of Conduct Code of Accountability for NHS Boards

¹⁰ DGM(95)5

D Local Government

(<http://www.dtlr.gov.uk/>)

(<http://www.cipfa.org.uk/>)

1. The current legal framework for local authorities¹¹ covering the actions and behaviour of members and officers is complex. The legislation sets down specific requirements in areas such as:
 - ◆ acceptance of office (Local Government Act 1972) (Section 83 et al);
 - ◆ creation of standards committees and a National Standards Board;
 - ◆ establishment of a code of conduct (Section 50, Local Government Act 2000);
 - ◆ establishment of *General Principles of Conduct in Local Government*;
 - ◆ disclosure and registration of members' interests (Section 81, Local Government Act 2000);
 - ◆ establishment of a Local Government Ombudsman (Part III, Local Government Act 1972);
 - ◆ responsibility of financial officers to stop irregular payments (Section 114, Local Government Finance Act 1998);
 - ◆ standing orders for the award of contracts (Section 35 Local Government Act 1972);
 - ◆ restrictions on political appointments (Local Government and Housing Act 1989).
2. The *General Principles of Conduct in Local Government* were issued in July 2000 and have statutory backing through section 49 of the Local Government Act 2000. The Local Government Act 2000 also provides for the Secretary of State to issue a model code of conduct, replacing the provisions of the Local Government and Housing Act 1989 for a National Code of Local Government Conduct. Local authorities are required to adopt a local code of conduct, incorporating any mandatory elements of the model code within six months of the order issuing the model code.
3. The model code is a guide for all members of councils and their committees and sub-committees, whether elected or co-opted. It emphasises, among other things, that compliance with the law, standing orders and the code is the personal responsibility of each councillor. It is not enough to avoid actual impropriety; each councillor should at all times avoid any occasion for suspicion and any appearance of improper conduct.
4. The *Code of Conduct for Local Government Employees* was issued in 1994 by the Local

¹¹ The Current Ethical Framework for English Councils; DETR

Government Management Board, supported by the local government associations. It is a voluntary code, recommended for adoption by all local authorities. The Code outlined existing laws, regulations and conditions of service and provided further guidance to assist local authorities and their employees in their day-to-day work. Section 82 of the Local Government Act 2000 empowers the Secretary of State (or the National Assembly for Wales) to issue a code of conduct for local government employees. The Code will replace the 1994 Code, and it will be a statutory requirement for local authorities to adopt it.

- 5.** There is a similar regime in Scottish local government, largely contained in the Local Government (Scotland) Acts 1973, 1975 and 1994.

E Education

Higher Education Funding Council for England (HEFCE) (<http://www.hefce.ac.uk/>)

1. Higher education institutions are, strictly speaking, independent institutions outside the public sector. But as the sector receives significant public funding, it is subject to parliamentary scrutiny.
2. Relevant guidance is produced by the Higher Education Funding Council for England. This includes:
 - ◆ Guidance on Severance Payments to Senior Staff (May 1997)
 - ◆ Circular 00/25 - Model Financial Memorandum between HEFCE and Institutions (June 2000)
 - ◆ Circular 98/28 - Audit Code of Practice (June 1998)

Committee of University Chairmen (CUC)

3. The Committee of University Chairmen (CUC) issued a revised *Guide for Members of Governing Bodies of Universities and Colleges in England, Wales and Northern Ireland* in April 1998. It builds on earlier guidance issued in June 1995 and draws attention to the expected conduct of Governing Body Business and the observance of the seven principles of public life expounded by the Nolan Committee. The guiding principles are to observe the highest standards of integrity and objectivity in the transaction of all its business, to follow a policy of openness and transparency, and to be accountable for public funds with a duty to maximise value for money. It also offers guidance to institutions on the handling of allegations made by staff members relating to the running of the institution or the activities of colleagues within the institutions (referred to as "whistle-blowing").
4. The CUC also organised a seminar in London on 25 May 1999 on the role of university audit committees.

Scottish Higher Education Funding Council (SHEFC) (<http://www.shefc.ac.uk/.htm>)

5. In March 1999, the Scottish Higher Education Funding Council issued the *Guide for Members of Governing Bodies of Scottish Higher Education Institutions and Good Practice Benchmarks*. This replaced the Council's previous *Guide for Governors* issued in 1997.

6. The Scottish Higher Education Funding Council issued a circular letter in December 1998 giving guidance on severance arrangements and also Public Interest Disclosure (Whistle-blowing). It was prepared by the Association of Heads of University Administration and endorsed by the SHEFC.
7. In January 1999, the SHEFC issued guidance on Overseas Student Operations. The SHEFC have a Code of Audit Practice relating to audits of Higher Education. Institutions in Scotland in place at present issued a revised code in 1999 following an extensive consultation exercise.

Learning and Skills Council (<http://www.lsc.gov.uk/>)

8. The Learning and Skills Council took over the role of funding further education in England from the Further Education Funding Council for England (FEFCE) from 1 April 2001. However, the guidance produced by the FEFCE remains valid for the sector and includes:
 - ◆ Guide for College Governors (1994);
 - ◆ College Governance: A Guide for Clerks (1996);
 - ◆ Governor Training Materials (March 2000);
 - ◆ Audit Code of Practice (1998);
 - ◆ Circular 96/24: Conduct of the Council's business;
 - ◆ The College Governor (May 2000);
 - ◆ Duties and Powers (October 1996);
 - ◆ Accountability in Further Education, Response from the FEFC (July 1998);
 - ◆ Circular 99/48 - Financial Memorandum.

Scottish Further Education Funding Council (SFEFC) (<http://www.sfefc.ac.uk/>)

9. The Scottish Further Education Funding Council took on its full range of responsibilities on 1 July 1999. Guidance from the Scottish Executive requires the Council to take early steps to issue appropriate guidance to assist colleges to achieve the highest standards of financial and management control, underpinned by sound governance arrangements.
10. Arrangements are also to be put in place by SFEFC to monitor the extent and speed with which this guidance and its recommendations for best practice have been implemented. The Council is addressing this agenda and has stated publicly that financial health, governance and management are among its key priorities. In particular, the Council is to carry out a comprehensive review of management of Scottish FE colleges at the specific request of the then Secretary of State.

- 11.** In terms of specific examples of good practice, the C&AG has issued a report *Corporate Governance and Financial Management in the Scottish Further Education Sector*. In April 1998, the Report outlined a whistle-blowing policy introduced by a college which was perceived to be an example of best practice for other colleges to consider. The whistle-blowing policy:
- ◆ made it clear that individual members of staff had a right and a duty to raise any matters of concern which they might have about perceived malpractice;
 - ◆ provided for informal discussions with other colleagues or management where staff were unsure of the best way of dealing with their concerns or needed to clarify their thoughts;
 - ◆ stressed that the source of any information provided would be kept confidential;
 - ◆ described how any complaints would be investigated;
 - ◆ explained that the outcome of the investigation would be notified to the complainant, but stressed that some information would remain confidential;
 - ◆ provided details of what further action staff could take if they were dissatisfied with the outcome of the investigation;
 - ◆ emphasised that the college would not tolerate the victimisation of staff who raised legitimate concerns;
 - ◆ made it clear that unfounded and malicious allegations would be treated seriously.

ELWa - Education and Learning Wales (<http://www.wfc.ac.uk/>)

- 12.** Higher education in Wales is funded through the Higher Education Funding Council for Wales, and further education is funded through the National Council for Education and Training for Wales. The latter is a new body that has taken over the responsibilities of the former Further Education Funding Council Wales from April 2001. Together the Higher Education Funding Council and the National Council for Education and Training are referred to as ELWa - Education and Learning Wales.

Higher Education in Wales (<http://www.wfc.ac.uk/hefcw/>)

- 13.** The HEFCW has a financial memorandum in place with each institution receiving funding from it. Guides for members and clerks of governing bodies have been issued and these are supplemented with guidance, advice and requirements aimed at ensuring propriety, accountability and openness. The HEFCW's audit regime for higher education institutions is laid down in its *Audit Code of Practice*, the requirements being identical to those in the further education sector.
- 14.** The Committee of Vice Chancellors and Principals has issued guidance on establishing procedures for handling complaints by staff and students. This complements guidance prepared by the Association of Heads of University Administration on whistle-blowing.

Further Education in Wales

- 15.** Much of the guidance developed by the former Welsh Office and the National Council for Education and Training for Wales's predecessor, the Further Education Funding Council for Wales FEFCW, remains valid. The National Council for Education and Training for Wales will be updating and consolidating the guidance it has inherited in due course.
- 16.** A *Guide for Governors* was published by the Welsh Office in March 1996. This was supplemented by the publication of a *Guide for Clerks to Governing Bodies* in August 1996. These guides contain detailed advice for governors on their responsibilities and on the way they conduct their business. The guiding principles are that governors should observe the highest standards of integrity and objectivity in the transaction of all their business and wherever possible should follow a policy of openness and transparency.
- 17.** FEFCW officers developed an updated *Guide for Governors*, in partnership with the Further Education Funding Council for England. The guide is accompanied by a range of new training material for governors and clerks for governing bodies. The National Assembly for Wales introduced modifications to further education corporations' instruments and articles of government in August 1999 requiring governing bodies to establish registers of interest and codes of conduct, though these were already in existence at many institutions. FEFCW also encouraged institutions to establish whistleblowing policies and this has now been reinforced by the requirements of the 1998 Public Interest Disclosure Act, which gives protection to employees who make certain disclosures of information in the public interest.
- 18.** FEFCWs' *Audit Code of Practice* sets out the audit arrangements required at further education institutions and the Code contains mandatory requirements in respect of the work of institutions' Audit Committees, their internal and external auditors.

Association of Colleges

- 19.** The Association of Colleges has issued a *Model Code of Ethics for Colleges* which lays down the general principles which can be used to determine whether actions conform to the standards and values expected within Further Education. The principles of the Nolan Committee are encompassed within the Model Code and is recommended as the basis for a code of conduct for governing bodies. In Scotland, the Association of Scottish Colleges has also been active in this area.

Schools (<http://www.dfes.gov.uk/>)

- 20.** Much of the conduct of school governors is governed by legislation. Consequently, relevant material is contained in the various *Guides to the Law for School Governors*. A further source is *Good Governance*, which includes the Nolan Committee's seven principles of public life.

