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## **HEALTH AND SAFETY COMMISSION**

### **Governance : Implications of the HMTreasury Led Review of HSE's Financial Management; reconstituting the Audit Committee**

**A Paper by Alan Sabberton and Bill Tomkins**

**Cleared by Vivienne Dews 2 March 2006**

#### **Issue**

1. To inform HSC of HMTreasury's (HMT) review of Financial Management in HSE and its implications. This paper also seeks agreement to revised terms of reference for the Audit Committee pending a wider discussion of governance issues at the Commission's residential meeting in June 2006.

#### **Timing**

2. Routine.

#### **Recommendation**

3. Commissioners are invited to note:
  - the findings of HMT's review (Annex A);
  - corporate governance issues will be considered in detail at the Commission's June residential meeting; and
  - the reconstitution of the Audit Committee as an HSC committee.

and to agree:

- the proposed terms of reference for the reconstituted Audit Committee (which are not considered to be contentious and are closely based on the Treasury's standard terms of reference).

#### **Background**

## Financial Management Review

4. A programme of Financial Management Reviews (Improving Financial Management: IFM) was announced in the 2004 Spending Review White Paper. It said

“As recommended by the Efficiency Review, HMTreasury will conduct a department-by-department review of the effectiveness of financial management. The review will begin with those departments with the biggest spending programmes. It will be led by Mary Keegan, as Head of the Government Accountancy Service’.....’It will provide an objective and professional assessment of each department against a common framework leading to a departmental action plan.”

5. It was not clear at first whether the review would apply to smaller departments or NDPBs like HSC and HSE. HSE decided to self-assess against the Framework in any case. In the event, HMT agreed that the review should include HSE. A review was carried out by an HMT Auditor in late 2005. Once the closely integrated relationship between HSC and HSE became clear to the auditor the review was extended to include interviews with Bill Callaghan and Judith Hackitt. The Treasury’s conclusions are at Annex A. The findings are generally positive and the overall outcome a good one.<sup>1</sup> It broadly reaffirms HSE’s self-assessment. The references to governance in the Appendix of the Treasury report are the most challenging for HSC/E,
6. Geoffrey Podger met Mary Keegan on 21 December and, following discussion with Bill Callaghan, accepted the Review in principle. He indicated that the governance issues raised could be considered as part of ongoing discussions on governance and the relationship between HSC and HSE.

## Audit and Assurance

7. HSE maintains an Internal Audit and Assurance function to support the Chief Executive in his role as HSE’s Accounting Officer. The head of Internal Audit has direct access to both the HSC and HSE Accounting Officers.<sup>2</sup> Overseeing and agreeing the work of Internal Audit is one of the Audit Committee’s primary functions. The present constitution of the Audit Committee is primarily of senior HSE managers with a Commissioner as chair (currently Judith Hackitt) and the head of DWP Internal Audit as the other ‘independent’ member.
8. The role of the Audit Committee with regard to HSC has been unclear. However, it has traditionally looked at the HSC’s accounts along with HSE’s and has been able to provide some assurance to the Chair as HSC’s Accounting Officer.

## **Argument**

9. HSC will consider governance issues at its June Residential meeting.
10. There is no reason to delay the reconstituting of the Audit Committee so that we come into line with current Treasury guidelines; this says that the membership of the audit committee should be primarily made up of non-executives. Reconstituting the Audit Committee as recommended will also serve to strengthen HSC/E’s governance.

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<sup>1</sup> Many of the recommendations are of an operational nature and will be addressed via established business improvement processes. e.g. review of HSE’s expense heads, progressing implementation of the Resource Management System.

<sup>2</sup> For line management purposes the Head of Internal Audit reports to the Director, Resources and Planning.

11. The linked nature of HSC and HSE suggests that a single committee is desirable and that it be an HSC committee. HSC is a non-executive body within the HSC/E set-up. It is also the body through which funds are channeled to HSE and for which HSE delivers many of its functions. It will avoid potential conflict of interest with the Commission's position if any additional non-executives are included in a Commission body rather than an HSE one. The Chair and HSE's Chief Executive have concluded that the Audit Committee should be reconstituted as
- an HSC Commissioner as Chair
  - one other Commissioner as a side member (and to act as vice chair)
  - DWP Head of Internal Audit
  - two non-executives (to be recruited) – one of these to have good financial management experience.
- The members of the Executive and the Director of Resources and Planning would attend but would **not** be members. Also the Head of Internal Audit and an NAO representative would attend. Draft terms of reference are at Annex B.
12. A decision on whether the new non-executive members should be paid has yet to be made. But it will be difficult (or impossible) to recruit people with the necessary skills and experience if this is unpaid.
13. This change strengthens HSC/Es governance by introducing a greater degree of challenge (from non-executives on the Audit Committee) and by clarifying the remit of the committee across HSC and HSE.
14. This constitution means that the recommendation of the Financial Management Review (that most members be non-executives) would be fully met.
15. A draft letter from Geoffrey Podger to HMT confirming acceptance of the report and reporting on HSC/E's response is at Annex C.

### **Consultation**

16. Senior PEFD managers, the Head of Internal Audit and NAO were consulted.

### **Presentation**

17. The Terms of reference for the reconstituted Audit Committee will be posted on to HSE's website. The letter from Mary Keegan and the reply from Geoffrey Podger will be included on the HSE intranet site along with some further explanation and information about actions being taken on the HSE operational issues identified.

### **Costs and Benefits**

18. It is impossible to quantify costs and benefits at this stage. Any changes which streamline and further strengthen HSC/E's Governance arrangements should result in more efficient processes and speedier decision making.

### **Financial/Resource Implications for HSE**

19. Reconstituting the Audit Committee could add an extra £10 - 15k per annum to payroll to fund the appointment of an additional two non-executive members. The cost of developing these proposals has been about £3k.

## Environmental Implications

20. None

## Other Implications

None

## Action

21. Commissioners are asked to note

- the outcomes of the Treasury Review of Financial Management in HSE;
  - the proposal that the governance issues will be discussed at the Commission's June residential meeting; and
  - the reconstitution of the Audit Committee as an HSC Committee with a revised membership;
- and to agree
- the proposed terms of reference for the Audit Committee.

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9 January 2006

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### **Financial Management Review**

As you know Ross Fraser has recently been working with your finance team to review key aspects of the Health & Safety Executive's financial management, benchmarked against a framework being used across government. Although HSE is a Crown NDPB, and therefore not strictly covered by the SRO4 White Paper remit, we nevertheless agreed to conduct the review and I am grateful for the open and co-operative approach taken by everyone in the Executive who has contributed to the review.

The conclusions of the review have been discussed with Vivienne Dews and are generally positive. I am now writing to document formally the joint conclusions of our work.

We noted some particular strengths and developments in your financial management procedures:

- A Torex based accounting system (TAS) is well established, produces timely 'on screen' reports within 6-7 days of month end (operating cost statement, balance sheet, cash flow; also to DWP monthly) and includes quarterly profiles. Everyone spoke highly of the current accounting system and the quality of reports.



- The monthly management accounts highlight issues at Budget Holder level and are reviewed by the Resource and Delivery Group. The HSE Board undertakes a quarterly review of the Balanced Scorecard which includes financial information, with a 'traffic light' system being used to highlight issues. There is also evidence that the Resource and Delivery Group undertakes robust in-year reviews of Directorate budgets.
- HSE has established an efficiency, economy and productivity programme with a target of producing savings of at least £50 million over the SR2004 period.
- The 2004-05 accounts were published on 7 July 2005, without qualification.
- The prime tool for providing an overview of corporate performance is HSE's Balanced Scorecard. This quarterly report provides strategic oversight of HSE's delivery and includes sections on *Financial Management and Monitoring* and *Allocating Resources to Operational Priorities*.
- Your corporate business plan shows good evidence of the underlying financial planning and awareness of risks.
- The Executive has five top level budget holders and each Directorate has a dedicated finance team which includes a finance professional. Guidance is available to Budget Holders in the form of a Budget Code. Formal letters of delegation are issued.

The current areas for development discussed with Vivienne are set out in the attached short report. A number of these have already been identified by your management team. Included in the list are the relevant timescales for action as discussed with Vivienne.

I am sending a copy of this letter to John Codling, Finance Director of the Department for Work and Pensions, and to Alison Cottrell, head of the Treasury's Labour Market Policy Team, who will be in touch with Vivienne in due course to monitor progress.



MARY KEEGAN

**Financial Management Review – Health & Safety Executive  
Development Areas**

**Governance**

The Chair and members of the Health & Safety Commission are all closely linked in some way to health and safety issues. All are very eminent persons in their own fields and bring a necessary diversity of experience, professionalism and knowledge to fulfilling the Commissioner role.

The Health & Safety at Work Act 1974 established the Commission and the Executive. The Act requires that funds for the Executive be channelled through the Commission and notes "the duty of the Commission to pay to the Executive such sums as the Commission considers appropriate for the purpose of enabling the Executive to perform its functions"<sup>1</sup>.

Another aspect of the Commissioners' responsibilities is to review the accounts, including to "state whether applicable accounting standards have been followed"<sup>2</sup>. Non-executives should also bring challenge to the executive before the accounts are finalised. However, the brief synopsis of each Commissioner included within the Annual Report indicates that none has finance or accounting professionalism. The Commission would be further strengthened if at least one Commissioner had a finance background.

*Timescale for action: Implementation to be considered as part of Chief Executive's current review of the responsibilities and relationship between HSC and HSE, including the role of Commissioners.*

Within the HSE top level structures (ie below the Commission) there are no independent non-executive members in a position constructively to challenge the business or to ensure that aspects of strategy and delivery are scrutinised for effectiveness and efficiency. If the HSE is seeking to model its governance on the recently published Code of Good Practice for central government departments, there should be a minimum of two independent non-executive members at top board level within HSE, preferably more.

*Timescale for action: Implementation to be considered as part of Chief Executive's current review of the responsibilities and relationship between HSC and HSE, including the role of Commissioners.*

Similarly, the membership of the Audit Committee is unusual in that the majority of members are executives: the Chief Executive plus the two Deputy Chief Executives, the Director of Resources & Planning, and the Head of Planning, Efficiency & Finance. The only external members are Judith Hackett (Commissioner), and DWP's Head of Internal Audit.

<sup>1</sup> Health and Safety at Work Act 1974 para 43(1)

<sup>2</sup> Health and Safety Commission/Executive Accounts 2004/05 : Statement of Responsibilities Page 69

HM Treasury's *Audit Committee Handbook* advises that the Audit Committee should be formed entirely, or at least primarily, of non-executives with a suitable mix of skills and experience. The Committee would, in addition, be more effective if at least one of the non-executives had a finance background.

*Timescale for action: Summer 2006*

#### **Budget management and delegation**

HSE has in excess of 400 expense codes. There is likely to be scope for improved efficiency by reducing the number of codes.

*Timescale for action: On going*

#### **The Finance Organisation**

The Director Resources and Planning, Vivienne Dews, is the Finance Director and a member of both the RDG and HSE Board. Vivienne is undertaking a course at the University of Warwick to achieve a professional finance qualification.

*Timescale for action: end 2006*

The Fundamental Review does not specifically mention coverage of the finance function, eg the scope for benchmarking on costs and transaction processes, or adopting a shared services approach. Management should actively consider these as a part of the Efficiency Review.

*Timescale for action: during the CSR 'baseline review' process*

#### **Recording systems**

Reporting financial performance by function is in place. An aspect of achieving the £50 million efficiency target is improving productivity by for example increasing the proportion of time spent by inspectors dealing with duty holders. Work in this area is complemented by initiatives to improve management accounting information, including the attribution of costs to objectives and, where appropriate, output costing. A key part of this is a resource management system, aimed at improving HSE's understanding of how its resources are deployed, which is currently being piloted in a number of areas.

The technical notes in support of the Efficiency Programme show that in the current financial year savings are expected but the data sources are still in development. Since we are now in the third quarter of the financial year there is an urgency to develop further HSE's management accounting information including unit costs. Failure to do so could put at risk achieving the anticipated savings and lead to a less well managed programme. The management team should review the planning, prioritisation and implementation timescales for these initiatives to ensure they are met.

*Timescale for action: during 2006/07*

**HSC AUDIT COMMITTEE  
DRAFT TERMS OF REFERENCE**

1. The HSC and HSE Accounting Officers have established an Audit Committee to support them in their responsibilities for issues of governance, risk, control and associated assurance by providing an independent view on appropriateness, adequacy and overall value for money.

**Aims**

2. The aims of the Audit committee are to
  - promote the highest standards of propriety in the use of public funds and encourage accountability for the use of those funds;
  - improve the quality of financial reporting and promote a climate of financial discipline and control; and
  - promote the development of internal control systems, including sensible business risk management.

**Authority**

3. The Committee is authorised
  - to investigate any activity within its terms of reference; and
  - to seek any information it requires from any HSE employee; all employees should co-operate with any request made by the Audit Committee;

**Membership of the Audit Committee**

3. The membership shall be
  - an health and safety commissioner as chair
  - [an health and safety commissioner as a side-member / vice chair]
  - a minimum of two independent non-executive members to be recruited competitively
  - the head of internal audit at DWP (who will act as chair in the absence of the usual chair)
4. In addition the following will normally attend
  - the HSC Chair; the members of the Executive
  - the Director, Resources and Planning
  - the head of Internal Audit
  - a representative of NAO

The Audit Committee will be provided with a secretarial function by HSE.

**Meetings**

5. The Audit Committee will meet at least three times per annum – in late spring, autumn and March each year.
6. A minimum of two members of the Audit Committee shall be present for the meeting to be quorate.
7. The Audit Committee may ask for other HSE officials to attend to assist with discussions on specific issues.

8. The Audit Committee may also ask for regular attendees who are not members to withdraw to facilitate full and frank discussion of particular matters.
9. The Accounting Officers may ask the Audit Committee to hold further meeting to discuss particular issues on which the Committee's advice is wanted.

### **Access**

10. The head of Internal Audit and the representative of NAO will have free and confidential access to the Audit Committee Chair.

### **Reporting**

11. The Audit Committee will formally report back in writing after each meeting to the Accounting Officers.

### **Responsibilities**

12. The Audit Committee will advise the Accounting Officers on the
  - adequacy of the management of governance, risk and control and the Statement on Internal Control;
  - adequacy and appropriateness of governance arrangements;
  - accounting policies, the accounts and the annual report of the organisation including the process for review of the accounts before submission for audit, levels of error identified, and HSC/E's letter of representation to the external auditors;
  - planned activity and results of both internal and external audit (including access to individual audit reports where Audit Committee members request such access) in relation to how this reflects business risk assessment;
  - adequacy of HSC/E's response to issues identified by audit activity, including NAO's report of audit;
  - adequacy of "whistleblowing" arrangements within HSE.

### **Information**

13. Before each meeting the committee will be provided with
  - A report summarising any significant change in the corporate risk register
  - A progress report from the head of internal audit summarising
    - progress on plan of work;
    - key issues emerging;
    - management response to audit recommendations;
    - changes to plan of work;
    - any resource issues affecting delivery of plan.
  - A progress report from external audit summarising work done and emerging findings (if any).
14. The Audit Committee will also be provided with (as necessary)
  - Proposals for changes to its terms of reference;
  - The Internal Audit Strategy.
  - The Internal audit plan in draft before each operating year;
  - The draft accounts
  - The draft Statement on Internal Control
  - A report on any changes to accounting policies
  - External Audit's Audit Report (NAO)
  - A report on co-operation between Internal and External Audit

- A report on any proposals to tender for audit functions;

Document2

**Draft Letter To Mary Keegan, HMT**

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**Financial Management Review: Health and Safety Executive (HSE)**

At our meeting on 21 December I accepted, in principle, the outcomes of the above Review. The Health and Safety Commission noted your subsequent letter (which included some development areas) at its meeting on 1 March.

The issues which are essentially operational issues for HSE will be taken forward by Vivienne Dews' Directorate.

Bill Callaghan, the Chair of the Commission, and I will consider further how best to respond to the report's other development areas as part of the ongoing discussion we are having on corporate governance and the developing relationship between HSC and HSE.

However, you will be interested to note that we have already decided to reconstitute our Audit Committee as a Commission body; with wholly non-executive membership at least one of whom will have a financial background.

I propose sending you an update on progress in summer. In the interim, if you have any questions please contact Vivienne or myself.

I am copying this note to John Codling, Finance Director-General at DWP; to Bill Callaghan and to Vivienne Dews.

**Geoffrey Podger**