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Dear Accounting Officer

GOVERNANCE STATEMENTS

This letter advises Accounting Officers in central government organisations about the governance statements that they will include in their annual reports and accounts. It takes effect from the accounts of 2011-12. A new annex 3.1 of *Managing Public Money* is attached.

DAO 01/11 described how, from the accounts of 2011-12, Governance Statements will replace Statements on Internal Control (SICs) in all reports and accounts of public sector organisations. Governance statements will cover the same ground as SICs, but will also discuss how governance in the organisation works, in line with the *Corporate Governance Code*¹. Governance Statements remain the personal responsibility of Accounting Officers.

Governance Statements for central government departments may also need to include material on how each department's oversight of its grants etc to local government and the NHS works. This additional requirement responds to concern in the Public Accounts Committee (PAC) that public resources should be used wisely, whether in central or local government. It will often be convenient to put just a summary of this material in the main statement, supplementing with a more detailed account on the department's website. The PAC is especially anxious that this part of governance statements should explain how the Accounting Officer gains assurance about value for money.

A revised annex 3.1 (attached) now comes into force. The main difference from the draft attached to DAO 01/11 is the new material about central-local relationships.

Please address your questions about this letter or the attachment to:

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Yours sincerely,

Paula Diggle

Paula Diggle
Treasury Officer of Accounts

¹ http://www.hm-treasury.gov.uk/psr_governance_corporate.htm

Annex 3.1

The Governance Statement

It is fundamental to each accounting officer's responsibilities to manage and control the resources used in his or her organisation. The governance statement, a key feature of the organisation's annual report and accounts, manifests how these duties have been carried out in the course of the year. It has three components: corporate governance, risk management and, in the case of some departments, oversight of certain local responsibilities.

Purpose

A3.1.1 Each accounting officer (AO) delegates responsibilities within his or her organisation so as to control its business and meet the standards set out in box 3.1 (see chapter 3). The systems used to do this should give adequate insight into the business of the organisation and its use of resources to allow the AO to make informed decisions about progress against business plans and if necessary steer performance back on track. In doing this the AO is usually supported by a board.

A3.1.2 These responsibilities are central to the AO's duties. To carry them out the AO needs to develop a keen sense of the risks and opportunities the organisation faces. In the light of the board's assessment of the organisation's appetite for risk, the AO needs to decide how to respond to the evolving perceived risks.

A3.1.3 The governance statement, for which the AO takes personal responsibility, brings together all these judgements about use of public resources as part of the annual report and accounts. It should give the reader a clear understanding of the dynamics and control structure of the business. Essentially, it records the stewardship of the organisation. Supplementing the accounts, it should provide a sense of the organisation's vulnerabilities and resilience to challenges.

Preparing the governance statement

A3.1.4 The governance statement is published in each organisation's annual report and accounts. It should be assembled from work through the year to gain assurance about performance and insight into the organisation's risk profile, its responses to the identified and emerging risks and its success in tackling them.

A3.1.5 There is no set template for the governance statement.

A3.1.6 The AO and the board have a number of inputs into this process:

- the board's annual review of its own processes and practices, informed by the views of its audit committee on the organisation's assurance arrangements;
- insight into the organisation's performance from internal audit, including an audit opinion on the quality of the systems of governance, management and risk control;
- feedback from the delegation chain(s) within the organisation about its business, its use of resources, its responses to risks, the extent to which in year budgets and

other targets have been met, and any other internal accountability mechanisms; including:

- bottom-up information and assessments to generate a full appreciation of performance and risks as they are perceived from within the organisation;
- end-to-end assessments of processes, since it is possible to neglect interdependent and compounded risks if only the components are considered;
- a high level overview of the organisation’s business so that systemic risks can be considered in the round;
- any evidence from internal control failures or poor risk management;
- potentially, information from whistleblowers;
- material from any arm’s length bodies (ALBs) connected with the organisation which may shed light on the performance of the organisation or its board.

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

Content of governance statement

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

- organise the governance statement;
- take account of input from within the organisation and from the board and its committees;
- where relevant, integrate information about the organisation’s ALBs, some of which may be material to the consolidated organisation;
- provide an explanation of how the department ensures that use of any resources granted to certain locally governed organisations (including the NHS) is satisfactory. See A3.1.12.

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

A3.1.10 All the items in this box are important. The risk assessment is critical. This is where the AO, supported by the board, should discuss how the organisation’s risk management and internal control mechanism work, and why they were chosen to deliver reasonable assurance about prevention, deterrent or other appropriate action to manage the actual and potential problems (or opportunities) facing the organisation. Avoiding lengthy description of process, it should assess the evidence about the effectiveness in practice of the risk management processes in place. In doing so it should face frankly up to any revealed deficiencies as risks have materialised.

¹ Including the external risks identified in the National Risk Assessment

² As set out in the Security Policy Framework

Box A3.1A: Essential features of the governance statement

- the governance framework of the organisation, including information about the board's committee structure, its attendance records, and the coverage of its work;
- the board's performance, including its assessment of its own effectiveness;
- highlights of board committee reports, notably by the audit and nomination committees;
- an account of corporate governance, including the board's assessment of its compliance with the *Corporate Governance Code*, with explanations of any departures;
- information about the quality of the data used by the board, and why the board finds it acceptable;
- where relevant (for certain central government departments), an account of how resources made available to certain locally governed organisations are distributed and how the department gains assurance about their satisfactory use;
- a risk assessment, including the organisation's risk profile, and how it is managed, including, subject to a public interest test:
 - any newly identified risk
 - a record of any ministerial directions given
 - a summary of any significant lapses of protective security (eg data losses).

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

Box A3.1B: Deciding what to include in the governance statement

- might the issue prejudice achievement of the business plan? – or other priorities?
- could the issue undermine the integrity or reputation of the organisation?
- what view does the board's audit committee take on the point?
- what advice or opinions have internal audit and/or external audit given?
- could delivery of the standards expected of the AO (box3.1) be at risk?
- might the issue make it harder to resist fraud or other misuse of resources?
- does the issue put a significant programme or project at risk?
- could the issue divert resources from another significant aspect of the business?
- could the issue have a material impact on the accounts?
- might national security or data integrity be put at risk?

Localism

A3.1.12 Government departments should include in their governance statements a summary account of how they achieve accountability for the grants they distribute to local government, schools, similar local government organisations and/or the NHS. It should cover:

- an account of how resources are distributed, eg in response to needs or desired change;
- how the accounting officer gains assurance about probity in the use of public funds;
- how the accounting officer achieves or encourages value for money in the local use of grants, eg through local arrangements which provide incentives to achieve good value;
- the use the accounting officer makes of disaggregated information about performance, including investigating apparent outliers and/or requiring those responsible locally to explain their results.

A3.1.13 This part of the governance statement should usually be backed by a fuller accountability systems statement on the department's website³. Such statements should evolve to reflect improving practice.

External audit

A3.1.14 The organisation's external auditor will review the governance statement for its consistency with the audited financial statement. The external auditor may report on:

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

³ See *Accountability: adapting to decentralisation* at <http://www.communities.gov.uk/publications/localgovernment/accountabilitydecentralisation> for more detail