

16. THE COMPLIANCE ISSUE

i) Introduction

- 16.1 In the last sub-section of our account of government actions following Professor Crow's Report, we reported on deficiencies of action in the current failure to recognise or to accept the need for ensurance of compliance with laid down procedures. In this section we take this important matter further.
- 16.2 In 1991 the procedures for the receipt and processing, consideration and determination of planning applications by the Department of Local Government and the Environment were rudimentary and rarely documented.
- 16.3 The irregularities which occurred in respect of the Mount Murray development appear to have arisen for reasons which include the shortcomings of procedures, the failures of staff of the planning office, the failures of Planning Committee, and the absence of credible mechanisms to devise proper procedures to deter such failures and/or to identify and correct those which occurred.
- 16.4 Accordingly, we have given careful consideration to the issues involving the proper regulation of planning applications and their determination by the Planning Committee and to the enforcement of compliance with such regulatory procedures as are introduced.
- 16.5 We make specific recommendations in section 19 in respect of many of the matters of concern which we raise in this particular section.

ii) Corporate Approach

- 16.6 In a pro forma letter dated 5th August 2002, Mr Corkill, Chief Minister, presented a "new initiative" on behalf of the Council of Ministers which he called "Corporate Government and Business Planning". The new initiative is said to seek to secure greater corporate working and greater use of business planning within government, to be about changing the role of the Council of Ministers, and to be about changing the role of the Chief Officers Group.¹ The Chief Officers' Group is described in sub-section 7 (xxi) above.
- 16.7 The nature of this initiative is explained further in the Isle of Man Government Annual Report 2002 which was laid before Tynwald on 15th October 2002, by Mr Corkill. The Annual Report 2002 records that "The present Council of Ministers, which came into office following the House of Keys election in November, 2001, has been reviewing the established arrangement and is proposing a number of significant changes which are aimed at –
- Improving Government's corporate working (joined up Government)
 - Introducing a consistent framework of Business Planning across Government and
 - Improving Government's accountability."²
- 16.8 Clearly, the Council of Ministers is looking to examples of the conduct of corporate bodies outside government and their adoption of principles of good corporate governance. We believe that some of the irregularities which occurred in dealing with the development at Mount Murray and the handling of those irregularities, as well as

¹ Pro forma letter 5.8.2002 R Corkill MHK Chief Minister, page 1

² Document L28 Isle of Man Government Annual Report 2002, first page of Introduction by the Chief Minister

the delays which occurred before the irregularities were acknowledged and addressed by government could have been avoided if appropriate procedures had been in place. For example, if ministers working with their Chief Executive Officers were more accountable to the Chief Minister for their actions or inaction; if proper procedures for the reporting of major events in, and decisions by, departments to the Council of Ministers and, possibly, by extension, to Tynwald had been in place; if proper procedures governing the day-to-day workings of the Department of Local Government and the Environment and, in particular, its Planning Committee and planning office, had been in place; and if there had been proper arrangements to ensure compliance with such procedures.

16.9 Under the sub-heading “Corporate Government” Mr Corkill in his letter of 5th August 2002 states:

“It was always envisaged that the Council of Ministers would provide a collective leadership of the Government and the proposals we are making will reinforce that essential proposition. We envisage more emphasis being given to the strategic role of the Council in determining priorities, setting the policy of Government and looking to Departments to play their parts in the delivery of the corporate strategy.

“There will, we envisage, be less emphasis on Departments determining their policy options in isolation. This will involve the Council of Ministers working more closely with Departments, bridging the gap which sometimes exists between the centre of Government and those that deliver services ‘at the sharp end’.

“We see also a new relationship between the Council of Ministers and the Chief Officer Group. Up to now, they have existed as separate entities. We see the Council of Ministers working with the Chief Officer Group and using the Chief Officer Group so that the Chief Officer Group becomes the agent of the Council of Ministers and accountable to the Council of Ministers in delivering business planning across Government and monitoring its effectiveness.”³

16.10 We support this focus on “Corporate Government”, and we support the proposition that the focus be extended to the adaptation and adoption of the principles of good corporate governance which are increasingly being urged upon corporations by professional bodies, courts and regulators. For instance, we consider that a culture of good corporate governance requires to be introduced into each government department, including proper procedures for the selection, training and monitoring of key officers; ensuring the integrity of each government department’s systems, including systems for controlling and monitoring risk, financial control and compliance with the law; monitoring the effectiveness of the governance practices under which each government department operates and making changes as needed; and overseeing the processes of disclosure and communication.⁴

iii) **Reports to Council of Ministers**

16.11 The Council of Ministers in exercising a corporate role as outlined above is surely dependent upon the reports which are made to it by the respective ministers and their Chief Executive Officers. It seems that there is no guidance in respect of the nature and extent of the events in, or the decisions by, departments which are required to be reported to the Council of Ministers. Mr Corkill acknowledged in his evidence to the Commission that the criteria, if any, for deciding whether or not a matter is reported to the Council of Ministers are largely determined in each department.⁵

³ Pro forma letter 5.8.2002 Richard Corkill MHK, Chief Minister, page 2

⁴ Extracted and modified from OECD Principles of Corporate Governance, page 22

⁵ Evidence of Mr Corkill P7 Notes Day 4 page 29

- 16.12 We consider that the Council of Ministers should be interested in applications for planning permissions in respect of major developments such as Mount Murray. We further consider that, if the principal planning permissions and their main conditions in respect of the development at Mount Murray had been reported to the Council of Ministers, either the Council of Ministers would have been better able to call the Department of Local Government and the Environment to account in respect of the building of houses for permanent residents at Mount Murray; or the Council of Ministers would have known all along that the houses which were to be built at Mount Murray could be occupied by permanent residents.
- 16.13 Notwithstanding the importance of the development, neither the applications for nor the grants of planning permissions in respect of Mount Murray were reported to the Council of Ministers, at least, no such reports are recorded in the minutes of the Council of Ministers. Indeed, there are no relevant references to Mount Murray in the minutes of the meetings of the Council of Ministers between 1989 and April 2002. All other evidence we have received on this matter indicates that the minutes record the position correctly.
- 16.14 Accordingly, we are firmly of the view that the Council of Ministers should prepare and authorise a document or documents setting out criteria for determining the nature and extent of the matters which the Council of Ministers requires to be reported to it by the ministers of the various departments. We recognise that ministers will always be at liberty to report such further matters as they may choose, but there should at least be some minimum standard for the reporting of matters to the Council of Ministers. We make this finding with particular regard to the Department of Local Government and the Environment and formulate our recommendations accordingly.

iv) Powers of Chief Minister

- 16.15 In his evidence to the Commission, Mr Gelling, the former Chief Minister, said “All the Ministers of Departments are the ones that have the power. The Chief Minister, believe it or not, has no power. The Ministers of the Departments have the power to control and to do anything within their Department. The Chief Minister is there to head up the Council of Ministers and represents the Island, off Island, in international circles and so on. Now, if a Minister decides to ignore the Chief Minister’s, what I would call, genuine request there’s only one solution which the Chief Minister has and that is to sack the Minister. There is no power of direction within the system.”⁶
- 16.16 Actually Mr Gelling is not quite right in his understanding of the situation. Section 6(1) of the Government Departments Act 1987, as amended, provides that “The Council of Ministers may, after consultation with any Department, give to the Department directions as to the exercise of its functions in relation to any matter which appears to the Council of Ministers to affect the public interest, and any Department shall comply with any such directions”. Section 6(2) of the Act provides that “Every Department shall supply to the Chief Minister such information, and render such other assistance, as the Chief Minister may from time to time require, and shall permit any person appointed for the purpose by the Chief Minister to inspect and make copies of its accounts, books, documents and papers, and shall afford such explanation thereof as that person may reasonably require.”

⁶ Evidence of Mr Gelling Q23 Transcript Day 21 page 32

- 16.17 Nevertheless, Mr Gelling's belief that he had had no power over his ministers was real enough. We have been given an account of Mr Gelling's unsuccessful endeavours when he was Chief Minister to obtain answers to questions from Mr Gilbey when the latter was Minister for Local Government and the Environment. Indeed, by 16th October 2001, Mr Gelling seems to have been reduced to writing to Mr Gilbey, his Minister for Local Government and the Environment, from his home and signing himself "Donald Gelling MHK, Malew and Santon."⁷
- 16.18 We further recognise the reality that for a matter to become the subject of discussion by the Council of Ministers as to whether or not that the Council should give a direction under section 6(1) of the 1987 Act, or for a matter to become the subject of a "requirement" by the Chief Minister under section 6(2) of the Act, the tenure of the minister concerned must be in question. The minister may take umbrage at the actions of his or her colleagues and resign, or he or she may refuse to comply, with the result that the Chief Minister has no choice but to appoint someone else in his or her place.
- 16.19 A Chief Minister who dismisses or otherwise "loses" a Minister may well have some difficulty in finding a suitably qualified successor if only because of the small number of the Members of Tynwald from whom such a successor can be chosen.
- 16.20 The situation is clearly unsatisfactory as it was described by Mr Gelling in his evidence to the Commission when he said "... if a Minister states that a situation, after enquiry, is perfectly correct and everything is legal and it is proper, then that is where you have to accept that is correct".⁸ Mr Gelling added the words "unless proved otherwise",⁹ but did not explain how it would be likely to be "proved otherwise". If we take the case of the irregularities which arose in respect of the development at Mount Murray, nothing was "proved otherwise" until Professor Crow reported at the end of the year 2000.
- 16.21 Accordingly, the Chief Minister and his Council of Ministers must adopt a more robust approach to addressing and resolving complaints and reports of departmental shortcomings than they did in the case of the irregularities in respect of the development at Mount Murray. The means to do so are available by direction or requirement under section 6 of the Government Departments Act 1987.

v) **Auditors**

- 16.22 We have examined the roles of both the Isle of Man Government's independent (or external) auditors (currently KPMG) and the Internal Audit Division of its Treasury Department in order to ascertain whether or not they have any relevance to the irregularities which occurred at Mount Murray and whether or not their roles may be modified to prevent or deter a recurrence of comparable irregularities in future. We refer in this report to KPMG as the external (rather than independent) auditors in contrast to the internal auditors of the Internal Audit Division of the Treasury.
- 16.23 Section 1(1) of the Audit Act 1983, as amended, provides that inter alia, all accounts of every department, every statutory board, and every local authority be audited in accordance with the Act.

⁷ Mr Vakil Document Q28 (C) and (F)

⁸ Evidence of Mr Gelling Q23 Transcript Day 21 page 32

⁹ Evidence of Mr Gelling Q23 Transcript Day 21 page 32

- 16.24 Sections 2 to 14 inclusive of the Act contain a variety of statutory requirements relating to the appointment of external auditors and to the conduct of the annual audit, including powers for the Treasury to make regulations¹⁰ and the requirement that the accounts of every body whose accounts are required to be audited under the Act be laid before Tynwald annually, together with the relevant auditor's reports thereon.¹¹ External auditors are appointed to serve for a three year period.¹²
- 16.25 Messrs KPMG have served as auditors to the Isle of Man Government for the years 1st April 1989 to 31st March 1995; and 1st April 1999 to 31st March 2002.¹³
- 16.26 The irregularities related to the Mount Murray development are outside the remit of KPMG. Likewise outside their remit are any contingent liabilities or capital commitments which may have resulted from or be a consequence of the irregularities. An example of such contingent liability could be any capital cost required to rectify the infrastructure deficiencies at Mount Murray, which we have already discussed.¹⁴ Messrs KPMG are in fact simply required to express an opinion as to whether or not the accounts have been properly prepared in accordance with the Accounts and Audit Regulations 1984 made under the Audit Act 1983 and complied with all other enactments applicable to the accounts.¹⁵
- 16.27 The written statement to the Commission of Inquiry given by Mr M Gardner,¹⁶ the current audit partner at Messrs KPMG, stated that their work as auditors focused on making sure that the government accounts as a whole are prepared in accordance with the regulations, within an acceptable level of materiality, and did not necessarily focus on individual government departments. Their principal work therefore revolves around the review and testing of the payments system through which all expenditure of government is processed.
- 16.28 When explaining to us the relationship between the external and internal audits, Mr Gardner said that wherever possible the external auditors liaise with the internal auditors, and if the internal auditors have conducted a piece of work upon which the external auditors can rely, then the latter will place reliance on that work so that there is not a duplication of effort.¹⁷ He said that such reliance was significant.
- 16.29 Mr Gardner added that, by and large, if there was a properly authorised invoice of a government department and if that invoice went through the Treasury without any reaction, then his firm would assume that everything was in order.¹⁸
- 16.30 Mr Gardner later said "Once the expenditure has been authorised, or approved by the Department, clearly we can't get involved in policy decisions. If the Department has agreed to pay that sum of money and it falls within the vote as voted on by Tynwald, and the subsequent invoice is then authorised by the Department, then I don't think we can then call into question whether that is authorised expenditure."¹⁹ It follows that, given a vote by Tynwald, the department in the form of the minister can

¹⁰ Audit Act 1983 section 8 Document L39

¹¹ Audit Act 1983 section 11 Document L39

¹² Audit Act 1983 section 2(1) Document L39

¹³ Mr Gardner Document Q48 pages 1 & 2

¹⁴ Section 13

¹⁵ Audit Act 1983 section 4 Document L39

¹⁶ Mr Gardner Document Q48 page 2

¹⁷ Evidence of Mr Gardner Q48 Transcript Day 25 page 75

¹⁸ Evidence of Mr Gardner Q48 Transcript Day 25 page 75

¹⁹ Evidence of Mr Gardner Q48 Transcript Day 25 page 79

authorise a payment without attracting comment from the Isle of Man Government's external auditors.

- 16.31 The irregularities and the contingent liabilities or capital commitments which may have resulted from them would appear to be within the remit of the Internal Audit Division of the Treasury which is headed by the Chief Internal Auditor and which carries out internal audit procedures within the Treasury and the other departments and Boards of the Isle of Man Government.
- 16.32 In his written evidence to the Commission, Mr K C McGreal, the Chief Internal Auditor and head of the Internal Audit Division of the Treasury, presented a document headed "Isle of Man Government Treasury – Internal Audit Division Terms of Reference" dated 4th November 1992²⁰ and a document headed "Isle of Man Government Treasury – Internal Audit Division Terms of Reference" dated 30th January 1997.²¹
- 16.33 Under the sub-heading "Introduction", the first three paragraphs of the respective terms of reference read as follows:
"1. The main objectives of systems of control within Government are:-
(a) to ensure compliance with statutory requirements;
(b) to ensure adherence to policies and directives;
(c) to safeguard assets;
(d) to promote the most economic, efficient and effective use of resources in achieving policies;
(e) to enable its business to be conducted in an orderly and efficient manner;
(f) to secure as far as possible the completeness and accuracy necessary to secure the foregoing objectives.
"It is the responsibility of each Accounting Officer to determine the precise nature and quality of the controls in the various systems that exist within his Department.
"2. The control systems in operation need to be reviewed by an independent body because serious defects can lead to fraud and other illegal acts. Also the Accounts and Audit Regulations require arrangements to be made for the internal audit of the accounting systems, accounting records and accounts of all bodies subject to audit under the provisions of the Audit Act 1983. These tasks are carried out by the Internal Audit Division (IAD) which is based within the Treasury.
"3. The objectives of IAD are to examine, evaluate and report on the adequacy of internal control throughout Government (each and every Department, Division, and activity is covered) as a contribution to the proper, economic, efficient and effective use of resources."²²
- 16.34 The terms of reference are capable of wide interpretation. However, their practice is more limited. Mr McGreal agreed²³ that management audit did not feature heavily in audits which have been carried out. Furthermore he said²⁴ that there was not a body within government which would undertake a separate independent role to provide management audit per se. Insofar as there was such a role it would be senior officer teams within each department charged with such a role.
- 16.35 It is instructive that, of the eighteen "visits" by the Internal Audit Division to the Department of Local Government and the Environment between July 1989 and

²⁰ Mr K McGreal Document Q47 A1

²¹ Mr K McGreal Document Q47 A2

²² Mr K McGreal Document Q47 A2

²³ Evidence of Mr McGreal Q47 Transcript Day 25 page 65

²⁴ Evidence of Mr McGreal Q47 Transcript Day 25 page 67

August 2002, the only visit to the planning office took place in March 2000 and appears to have been primarily concerned with the security or otherwise of the planning office's minor cash.²⁵

- 16.36 In his oral evidence to the Commission, Mr McGreal confirmed that town and country planning at the Department of Local Government and the Environment formed part of the remit of the Internal Audit Division of the Treasury. However, he went on to say "I suspect, in terms of looking at the audit activity in the Department over the last ten years which I have provided a synopsis of, it's probably true to say that the town and country planning administrative arrangements haven't been subject to any degree of review rigour so, in that respect, it's not possible to indicate whether the arrangements have been adequately followed or not."²⁶
- 16.37 Mr McGreal explained to the Commission that a major factor of his involvement in the context of planning procedures relating to the Planning Committee would be whether the Chief Executive asked for an audit of administrative procedures in the planning office. He added that it would be unlikely that, in the absence of such a request, the Internal Audit Division would look at the planning procedures relating to the Planning Committee.²⁷
- 16.38 It follows that notwithstanding the variety of expressions of public disquiet about the development at Mount Murray, the Internal Audit Division of the Treasury has not examined the conduct of the planning office of the Department of Local Government and the Environment in order to quantify the liabilities real and contingent which have resulted from the irregularities in relation to Mount Murray, nor contributed to the establishment of systems and procedures which would serve to prevent such irregularities occurring again.

vi) Views on Compliance

- 16.39 The irregularities which occurred in government in respect of the development at Mount Murray occurred at least in part by reason of incompetence of and/or mismanagement by members of the staff of the Department of Local Government and the Environment, in the absence of any measures to ensure compliance with the rudimentary systems then operated by the department. We hold the view that it is no longer sufficient to appoint officers and to presume that they will carry out their duties and follow procedures without a measure of oversight to ensure compliance.
- 16.40 We do not share the views of Mr Hamilton and Mr McCauley, as set out in sub-section 15 (vii) to the effect that management in itself is sufficient to ensure compliance. Their views and description of the effective operation of the compliance functions in the planning office of the Department of Local Government and the Environment during the 1990s is clearly at odds with most of the known facts relating to Mount Murray over those years.
- 16.41 The operation of proper compliance functions is no more than the Isle of Man Government expects of the various financial institutions which its authorities license and authorise to carry on their financial businesses in the Island. There is no reason why it should not scrutinise its own actions in the same way.

²⁵ Mr K McGreal Q47 Transcript Day 25 pages 60 & 61 and Document Q47 Appendix 3 part 14

²⁶ Evidence of Mr McGreal Q47 Transcript Day 25 page 56

²⁷ Evidence of Mr McGreal Q47 Transcript Day 25 pages 64 & 65

vii) **Proposed Audit Commission**

- 16.42 On the evidence before the Commission, we conclude that the function of the external auditors is very largely mechanical and that it does not provide any serious potential for criticism of procedures which are wasteful and inefficient or for comment on accounts which do not fully reflect the state of affairs within the Isle of Man Government.
- 16.43 In addition, on the evidence before the Commission, we further conclude that, if the Internal Audit Division was fulfilling its functions, it could and should have made at least some enquiry into the alleged shortcomings in the Planning Committee and its planning office, the procedures of the Planning Committee and its planning office, and should have tested the quality of compliance with the procedures. In the event, it did not and, indeed, it seems that it never would have done so in the continuing absence of an invitation from the Chief Executive/Accounting Officer of the Department of Local Government and the Environment. The Commission notes the helpful representations²⁸ of Mr McGreal, Chief Internal Auditor, concerning the conclusion set out in this paragraph. Mr McGreal is, of course, recently arrived in post, but his representation confirms the difficulties with which he is faced in ensuring appropriate compliance, and which we would expect would be met and overcome by our proposal for an Audit Commission.
- 16.44 The Commission acknowledges the likely logic for the creation of the Isle of Man Government's Internal Audit Department as a Division of the Treasury. However, since then, the Civil Service has grown to some 1,850 officers, the ministerial system of government has been introduced and sophisticated systems of regulation and compliance have been devised by agencies of the Isle of Man Government for financial institutions, including banks and insurance companies, carrying on business in the Island.
- 16.45 In the light of these developments, the Commission is surprised that the Isle of Man Government has not adopted comparable systems of regulation and compliance for its government departments and statutory boards and that matters such as the irregularities which occurred in the Planning Committee and its planning office in respect of the development at Mount Murray went unexamined for a decade. Even then, the irregularities were not examined by the Internal Audit Division, but by Professor Crow.
- 16.46 In the circumstances, we consider that the government departments and statutory boards of the Isle of Man Government are of sufficient magnitude and must command the expenditure of sums of money of such magnitude as to warrant being overseen by a more independent body exercising the functions of an audit committee, an audit department and a compliance department to oversee the introduction and review of suitable procedures and internal controls for the conduct of the business of the government departments and statutory boards of the Isle of Man Government; and to enforce compliance with the various procedures and internal controls of the various government departments and statutory boards. The body would embrace the functions which are currently undertaken by both the external auditors and the internal auditors but it would be able to retain the services of external auditors in such exceptional cases as are considered appropriate.
- 16.47 Accordingly, as we say in our recommendations, the Council of Ministers needs to give consideration to the establishment of an independent statutory board which is

²⁸ Annex 4

responsible for the proper conduct of both audit and compliance throughout the Isle of Man Government. This statutory board could be named the "Audit Commission" and should be modelled upon the Financial Supervision Commission and the Insurance and Pensions Authority. The proposed Audit Commission would comprise not less than three members, one of whom would be appointed to serve as chairman. We are of the view that the government would be better served if the chairman is not a Member of Tynwald and is independent of government. The chairman and members should have competence in the fields of audit, systems and compliance and be served by a professional staff skilled in the practices of audit, systems and compliance.

End of Section 16

