



National Audit Office

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NATIONAL AUDIT OFFICE

TRANSPARENCY  
REPORT  
2016

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Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £1.21 billion in 2015.

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This report can be found on the National Audit Office website at [www.nao.org.uk](http://www.nao.org.uk)

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# INTRODUCTION

This Transparency Report has been prepared to meet the provisions in the Statutory Auditors (Transparency) Instrument 2008 (the Instrument). Although the Instrument does not cover our work, we choose to produce this report to comply with best practice. The National Audit Office Board endorsed this report on 17 November 2016.

# FOREWORD

## From the Comptroller and Auditor General

My role as Comptroller and Auditor General is to support Parliament in holding government to account for spending public money. I am supported by the National Audit Office (NAO) in discharging that role. Naturally, it is right that Parliament asks questions of me about how I fulfil that role.

The public sector faces considerable challenges. Central government and local bodies must deliver high-quality public services with less financial resource. To do this, they are seeking to change the way they operate, using new digital technology, requiring new skills and more integrated, joined-up working between public bodies.

My aim and that of the NAO is to ensure we make the best possible contribution to ensuring value for money for citizens and providing assurance to Parliament. The NAO must stay ahead of challenges faced by public services and bring the best knowledge, skills and insight to every audit we do so Parliament and the bodies we audit can have confidence in our findings. We must also reach out to Parliament and those we audit, and deliver timely work in the areas most challenging to the public sector and most likely to add value and improve services for citizens.

Our Annual Report and Accounts for 2015-16 sets out the progress made against this strategy. This Transparency Report complements our Annual Report and Accounts by focusing on how we made sure our audit work was of the highest quality and met the highest professional standards expected of us as well as making sure that we remained accountable to Parliament.

Transparency is vital to maintaining quality and stakeholder confidence. Therefore, I am pleased to report to our stakeholders on how we are discharging our responsibilities on audit quality and I welcome any comments you have on any aspect of this report.



Sir Amyas C E  
Morse KCB

Comptroller and  
Auditor General  
National Audit Office

# PART ONE

## ABOUT US



Michael  
Whitehouse

Chief Operating Officer

“The NAO is at the heart of public accountability, supporting Parliament and the government to improve how public bodies use their resources.

This section sets out our role and function, and the significant impacts we achieve.”

## Comptroller and Auditor General

**1.1** The Comptroller and Auditor General (C&AG) is appointed by Her Majesty the Queen as an Officer of the House of Commons. He is appointed for a single non-renewable term of 10 years; and can only be removed from office by the Queen on an address by both Houses of Parliament. The C&AG has extensive statutory rights of access to information held by a wide range of public sector organisations. The C&AG's inspection rights extend to the records of many contractors to central government and those who receive public money.

**1.2** To preserve his independence from government, he has complete discretion in carrying out his functions, and responsibility for all audit opinions and judgements rests with the C&AG alone. The C&AG is also the CEO and Accounting Officer of the National Audit Office (NAO) and is accountable to Parliament for operating the NAO and how we use public money. In carrying out the statutory duties of the post, the C&AG is supported by an Executive Leadership team and statutory Board, which set our strategic direction. A parliamentary committee, the Public Accounts Commission (PAC), oversees our work, appoints our external auditors and scrutinises our performance. There is further information on our governance and structure in Appendix One: Governance and accountability.

**1.3** Both the C&AG and our staff are totally independent from the government. We are not civil servants and do not report to a minister. We can be effective only if we remain able to report objectively and independently on what the government does. We do not advise on policy or on the specific decisions the government takes.

## Our role

**1.4** We scrutinise public spending for Parliament. We are a body corporate established under the Budget Responsibility and National Audit Act 2011.

**1.5** Our audit of central government has two main aims. By reporting the results of our audit to Parliament, we hold government departments and bodies to account for how they use public money, thereby safeguarding taxpayers' interests. Our work also aims to help public service managers improve performance and service provision.

**1.6** We audit the financial statements of nearly all central government organisations, and report on them to Parliament. This is our 'financial audit' work. In 2015-16, we certified 368 accounts with audited expenditure amounting to £1.6 trillion.

**1.7** We also examine particular areas of central government expenditure to establish whether public funds have been used economically, efficiently and effectively and report the outcome to Parliament. This strand of our work is called 'value for money (VfM) audit'. In 2015-16, we published 65 VfM reports on key government initiatives and the current challenges government faces. We developed our investigative capacity and capability, and in 2015-16 we completed 43 investigations. When appropriate, we examine programmes early on, to identify potential risks and comment on whether they are developed to optimise value for money. The C&AG selects the areas for us to investigate.

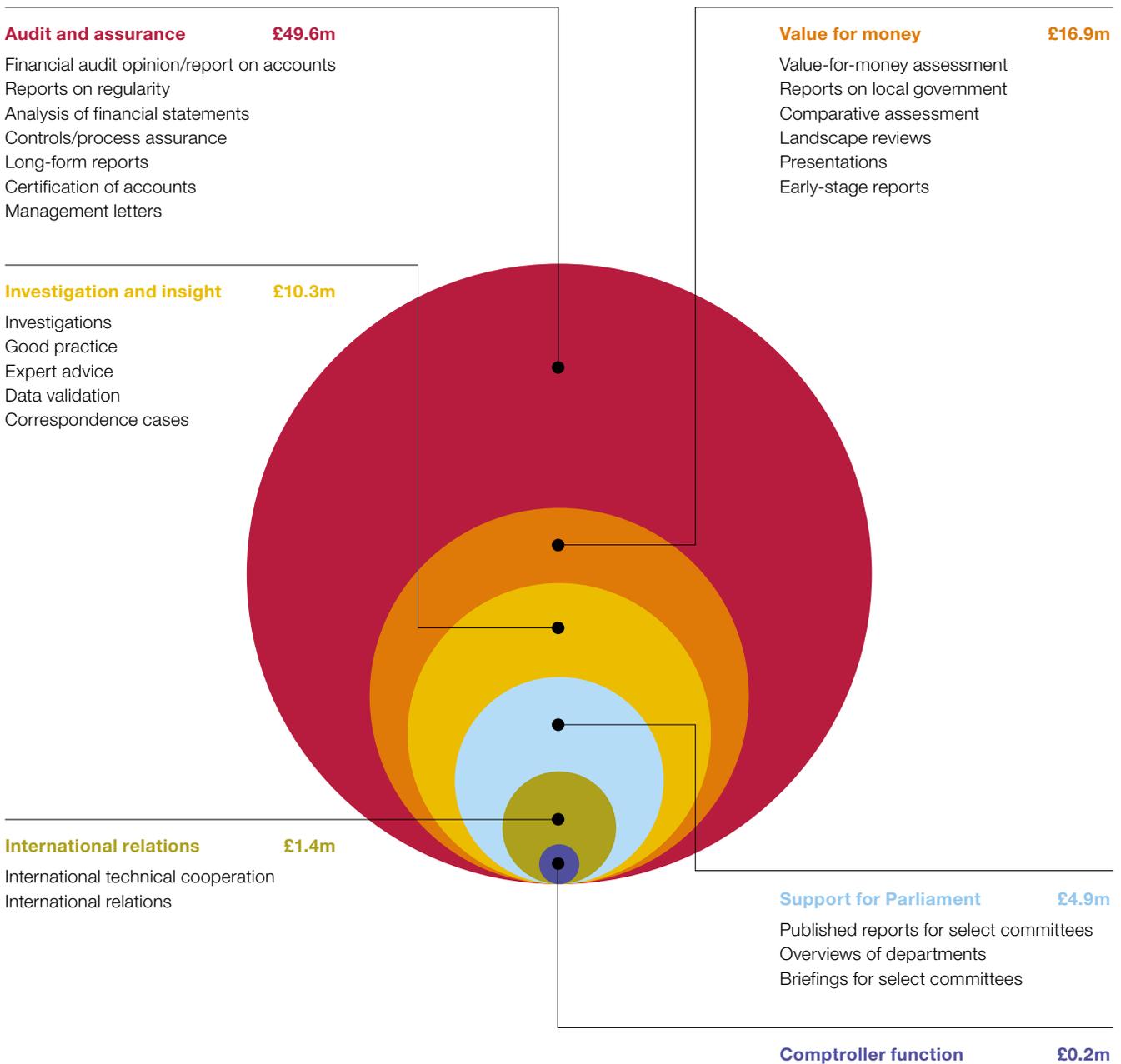
### KEY FACTS

we exceeded our target of £645m and achieved validated savings to government of

**£1.21bn**

**1.8** We do a range of work to help the bodies we audit, in line with our overall strategic goal to improve accountability and public services. Our financial audits and reports form part of a wider integrated assurance approach involving a proportionate and risk-based approach and an extensive range of outputs and products. Our Strategy 2016-17 to 2018-19<sup>1</sup> sets out how our public audit perspective will help Parliament hold government to account. The diagram summarises the range of our work, including financial and VfM audit:

The range of our work



1 National Audit Office, *NAO Strategy 2016-17 to 2018-19*, November 2015. Available at: [www.nao.org.uk/wp-content/uploads/2016/05/NAO-Strategy-2016-17-to-2018-19-final.pdf](http://www.nao.org.uk/wp-content/uploads/2016/05/NAO-Strategy-2016-17-to-2018-19-final.pdf)

## Our values

**1.9** Our values embody the aspirations for the organisation. They underpin our work and how we behave with the bodies we audit, with other stakeholders and with each other.

### KEY FACTS

368  
accounts certified



### INDEPENDENT

We are independent and objective, and observe the highest professional and personal standards.



### AUTHORITATIVE

We deliver work of the highest quality, drawing comprehensively on robust evidence and practice.



### COLLABORATIVE

We work collaboratively with colleagues, and with stakeholders, to achieve our goals.



### FAIR

Our work, and the way that we treat people, is fair and just.

**KEY FACTS****65**major outputs including  
14 comparative studies

## Impact of our work

**1.10** We use our work to help the organisations we audit make progress with the strategic issues they face. We measure and report annually on the impact of our work. The audited bodies concerned confirm these ‘impacts’ and our external auditor also gives assurance on them. In 2015-16, we reported a financial impact of £1.21 billion savings to government departments. In addition to financial impacts, we engage with the government to improve financial management, thereby improving public services. We report the financial and wider impacts of our work each year in our annual report, which can be found on our [website](#).

**1.11** We also monitor Treasury Minutes documenting the government’s response to Committee of Public Accounts recommendations. We further monitor the implementation of our own recommendations across government as an additional measure of our impact. This helps to identify systematic issues and serves to further focus our work.

**1.12** An important quality measure for our work – in financial and VfM audit and our wider assurance work – is how much it supports our objective to help Parliament hold government to account and improve public services. We commission independent qualitative interviews with senior civil servants and chairs of audit committees, and we use this feedback to improve our work and our communications with departments.

**1.13** The 2015 research findings highlight improvements made compared to previous years. Respondents thought our financial audit work was appropriately thorough and focused on the areas of greatest risk and 98% of them said that they would actively seek NAO feedback on accounting and financial control issues. Improvements were noted by the respondents in the NAO making fair and balanced judgements and the NAO teams sharing pan-government knowledge.

**1.14** We survey all clients following publication or certification. Client feedback in 2015-16 highlighted that 85% of the respondents thought that the technical quality of our work was good and 89% that the report was relevant to their work.

## Reputation of the NAO

**The quality and expertise of the NAO is widely recognised.** The summary of our client feedback research in 2015 includes scores from interviews with 80 respondents, across 28 audited bodies. The diagram (right) summarises the aggregate score of all questions against four areas – all questions were based on a scale of one to five with five being the most favourable.



## Promoting better oversight of local authority funding

Following our 2014 report into the financial sustainability of local authorities, the Department for Communities and Local Government improved how it oversees and manages local authority financing.

**Impact:** The Department has changed the definition of its main measure of local authority revenue income, which now excludes ring-fenced funding streams or those not fully under local authorities' control. It now monitors local authorities' financial health more systematically using a standard set of indicators. It also improved its Spending Review submission by collecting information from all departments with statutory responsibilities delivered by local authorities, and by modelling how policy options may affect different local authorities.

**KEY FACTS**

43

investigations and nine studies on local service delivery

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**Improving grant management in government**

Our work on grants shines a light on an area that government had previously given less attention to than any other policy funding mechanism, despite grant funding being higher in value. Our July 2014 landscape report on government grant services, developed through close engagement with the Cabinet Office, highlighted that grant funding made up 41% (£292 billion) of total government expenditure.

Our October 2015 investigation into government funding of Keeping Kids Company identified that the charity received at least £46 million of public spending despite officials raising concerns about the charity's cash flow and financial sustainability.

**Impact:** This work supported two high-profile parliamentary inquiries. Working closely with the Cabinet Office's Grants Efficiency Programme, in November 2015 we launched a good-practice toolkit on competitive and demand-led grants aimed at supporting grants administrators and Senior Responsible Officers. Because of our work, the Cabinet Office and the Department for Education are carrying out fundamental reviews of how non-competitive grants are managed, with the intention of improving grant management across government.

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**Measuring the benefits of major rail infrastructure projects**

Our 2012 report *The completion and sale of High Speed 1* recommended that the Department for Transport evaluate whether costs and benefits were delivered to expectations, particularly regarding regeneration benefits.

**Impact:** In 2015, the Department published its first evaluation, supplemented by additional work from specialist academics. The Department agrees it still has more to do to make sure other transformational projects such as High Speed 2, Crossrail and other major rail infrastructure projects are set up to make full use of the economic opportunities they create. In response, it has publicly committed to improving its planning, delivery and monitoring of these opportunities.

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## Improved management of accommodation for asylum seekers

In response to correspondence, we investigated the operation of the Home Office's contracts for the provision of accommodation for asylum seekers (known as COMPASS). The Home Office agreed with our recommendations that it should improve contract delivery by working more closely with the private sector providers to help them improve performance in a number of areas. Changes made since the report include new joint accommodation inspections, training on activity monitoring, improved policies and processes for delivering maintenance services, investing in existing stock and replacing properties below quality standards.

**Impact:** The Minister for Immigration recently confirmed that, in using our recommendations, standards have improved, and service credits incurred by suppliers are now much lower (£158,000 compared to £5.6 million three years ago).

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# PART TWO

## AUDIT INDEPENDENCE AND QUALITY

This section describes the importance of our independence and our methods of training, quality assurance and quality review.

## Introduction

**2.1** The Comptroller and Auditor General (C&AG), supported by the National Audit Office (NAO), undertakes around 380 assurance engagements each year. These vary in size from large government departments, such as the Department for Work & Pensions, to small incorporated subsidiaries of government-owned charities. The C&AG is appointed by statute to audit all government departments, agencies and the vast majority of arm's-length bodies. This means that he is the sole financial auditor of central government bodies. The C&AG is also appointed under agreement to audit other government bodies (for example, Network Rail) and a number of government-owned companies.

**2.2** The C&AG also provides Parliament assurance on whether government organisations use their resources with economy, efficiency and effectiveness. Our value-for-money (VfM) audit work helps Parliament scrutinise a wide range of major departments and programmes, holds government to account and helps public bodies to improve how they provide services. Our VfM audits also show how public money is spent. They are a cornerstone of democratic accountability and a crucial part of what makes public audit unique.

**2.3** In addition to financial and VfM audits, we contribute to improving public services through the provision of other assurance products. Investigations are increasingly undertaken as a mechanism of timely reporting to Parliament on emerging risks and public concern, helping us secure influence. The same principles of independence, quality and integrity apply to all our products.

## Quality control

### Leadership

**2.4** The Leadership Team, consisting of the C&AG, chief operating officer and executive leaders, provides the strategic direction for our work. It ensures that we focus appropriate resources on the main risks facing the public sector, and that this work supports our strategic goal of improving accountability and public services.

**2.5** The Leadership Team is supported by the Audit Practice and Quality committee (APQ), which considers the technical quality of our work. It makes sure that our methodologies and audit approaches are fit for purpose and meet good practice, and it scrutinises quality assurance arrangements.

### KEY FACTS

47

Committee of Public Accounts evidence sessions

22

short guides published at the beginning of the new Parliament

**KEY FACTS****£2.7m**income from our work  
with the United Nations**£0.6m**income from  
helping strengthen  
other Supreme Audit  
Institutions

**2.6** Overall responsibility for the NAO's system of quality control rests with the C&AG. However, the chief operating officer has been appointed as the senior reporting officer for quality. The C&AG has also appointed two of the NAO's executive leaders as senior audit practitioners, who lead on financial audit quality on behalf of the Leadership Team. The C&AG and the Leadership Team are supported and advised by the director of financial audit practice and quality and the director of value for money practice and quality. These directors are the NAO's heads of professional practice for their specialisms, holding operational responsibility for quality across our financial audit and value-for-money work respectively.

**2.7** The C&AG and the Leadership Team are also supported by the Compliance and Quality Unit, and quality leads within each cluster. Appendix One: Governance and accountability and Appendix Two: Assurance and control explain how we are structured in more detail.

## Independence

**2.8** For our work to have the impact and influence required, we must uphold high standards of ethics and probity, and work within a framework of values that preserve audit independence. In carrying out our work we adhere to our values.

**2.9** We expect staff to adhere to the relevant internal and external quality standards for our work. This includes International Standards on Auditing (ISAs) (UK and Ireland), our VfM and non-financial audit standards, *Ethical Standards for Auditors* published by the Financial Reporting Council (FRC), in so far as these can be applied to a statutory public sector audit body, and International Standard on Quality Control (UK and Ireland) (ISQC 1). The directors of financial audit and VfM practice and quality are responsible for ensuring compliance with the relevant quality standards for their specialisms and for creating a culture of professionalism, rigour and openness to challenge.

**2.10** The C&AG is our 'ethics partner' (as defined by the FRC's Ethical Standard 1). His independence is enshrined in statute. We are alert to areas where and how the NAO, or our engagement teams' independence and objectivity could be, or perceived to be, threatened. All staff must attend training to ensure that they understand the ethical and professional standards with which they must comply. An annual declaration is required by all staff to confirm that they are aware of their ethical and professional obligations.

**2.11** There are strong safeguards against threats to our independence. We are appointed to most audits (including VfM) by statute. This means that the audited entity cannot replace us as auditor in response to negative audit opinions. Moreover, we do not seek to profit from providing non-audit services to clients. This virtually eliminates threats to independence that could arise from an auditor seeking to protect non-audit income. Where appropriate, we fully implement the standards' safeguards. For example, to prevent over-familiarity of audit staff with the client, we regularly rotate senior staff on financial audit in line with the requirements of professional standards. Detailed procedures for identifying potential threats to independence and establishing appropriate safeguards are embedded into our audit methodology.

**2.12** The Ethical Standards are primarily designed to address issues of auditor independence in commercial practice. There are therefore a small number of areas where the Ethical Standards do not align to our circumstances. The key area of divergence is in secondments. The Ethical Standards prohibit secondments which are not short term and those which involve an individual taking management decisions at audited bodies.

**2.13** Secondments are an important way for us to develop staff and increase our corporate knowledge of the sector. This enhances the overall quality of our work. In addition, we are a key source of financial management expertise within government. It is important that we make this expertise available to further develop financial management capacity in government. As the auditor for the entire central government sector, the requirements of the standards restrict us more than the private sector, where they can use secondments to non-clients to enhance their skills within specific sectors. Government performs unique functions, thereby limiting our scope for enhancing our skills. When we consider the case for a more senior secondment, we assess all the potential threats and put in place enhanced safeguards. For example, additional independent reviews of the relevant audits.

**2.14** We currently draw on a small number of junior inward secondments to support our understanding of the complex legislative environment on an area which is subject to a long-standing qualification. Their work is fully directed, overseen and reviewed by senior NAO staff.

**2.15** The Audit Quality Review Team has highlighted that our secondments policy does not reflect the requirements of the *Ethical Standards for Auditors*. We continue to engage with the FRC on this matter. Following consultation on and revision of the Ethical Standard, the NAO will be reviewing its policies relating to ethics. The new Ethical Standard will be applicable to audits of financial years beginning on or after 17 June 2016.

## KEY FACTS

# 796

full-time equivalent employees



## Our people

**2.16** We deliver high-quality work because we invest in recruiting, developing and retaining the right people. The vast majority of people working in financial audit are either Consultative Committee of Accountancy Bodies (CCAB) qualified or in training for a CCAB qualification. In addition, we use specialists to support audit teams, for example statisticians and IT specialists. Many staff engaged on VfM audit also trained with us as accountants. We also recruit analysts and senior analysts in many specialist analytical disciplines, including economics, statistics, social research and operational research. Our trainee accountants and specialist staff follow clearly defined development paths to gain the necessary experience and develop their expertise.

**2.17** We have implemented a comprehensive skills strategy. This emphasises the importance of learning new skills on the job. This ensures that we develop expertise to support the consideration of the strategic issues across the range of our audit bodies. In recent years, we have recruited senior-level expertise in local government, corporate finance, health, and IT and digital, among a broad range of disciplines. We seek to disseminate this expertise across the NAO by promoting collaboration and knowledge-sharing.

**2.18** The professional accountancy training for staff is supplemented by in-house training in both financial and value-for-money audits. All qualified financial audit staff working on financial audit must attend an annual technical update and have further training on specific areas. On average, people in the NAO undertook 6.5 days of structured training during 2015-16. This includes training in areas of specialist accounting and central government audit.

## High-quality performance

**2.19** Financial audit work follows a standardised format, as it conforms with International Standards on Auditing (UK and Ireland). But our VfM assurance work is varied, and becoming increasingly so, as we aim to satisfy the needs of many audiences in government and Parliament. It can range from traditional 'value-for-money reports' evaluating major projects ex-post, to 'early looks' at major programmes, to landscape reviews of particular policy areas, and briefings on specific issues. We also undertake investigations of specific problems, such as our work on the issue of grants to the high-profile charity Kids Company.

## Value for money

**2.20** We expect staff to meet internal and external quality standards set for VfM, which stipulate clear quality-review requirements and responsibilities within audit teams.

**2.21** Our standards set out the mandatory principles that all VfM studies must meet, together with the guidance on current approaches to implementing the standards. These standards are based on current best NAO practice. They are consistent with the Fundamental Auditing Principles of the International Standards of Supreme Audit Institutions (ISSAIs), tailored to meet the specific expectations and requirements of the UK public sector environment and Parliament. They are accompanied by a more detailed explanation of current approaches to implementing the standards. We reviewed the standards to reflect the full range of work undertaken by the NAO. These were issued in January 2016. Further details on the standards are set out in Appendix Two: Assurance and control.

**2.22** VfM studies are subject to a multi-stage quality assurance process involving a core of mandatory elements and both internal and external review (see Appendix Two: Assurance and control for further information). Our internal cold review process checks adherence with the VfM and non-financial audit standards and identifies and disseminates lessons to improve our VfM work. Our investigations draw on an adapted version of the quality assurance framework set out for VfM studies.

## Financial audit

**2.23** All our financial audit work complies with auditing standards. The C&AG must perform certain discretionary audits under the ISAs (UK and Ireland), and he has chosen to adopt these standards for all financial audits. These standards include International Standards on Quality Control 1 (ISQC 1 (UK and Ireland)). Meeting these standards means that our financial audit work also complies with the relevant International Standards for Supreme Audit Institutions (ISSAIs) established by the International Organisation for Supreme Audit Institutions (INTOSAI).

**2.24** We engage widely with the accountancy and auditing professions, through the professional institutes, with other UK and international public audit bodies and through our private sector partnership firms. This helps us to share good practice and learn from other practitioners. We assess our audit methodology against that used by our partnership firms to ensure that this reflects current best practice. In addition, the NAO and its staff are appointed to a wide range of professional bodies and committees including the Council of the Institute of Chartered Accountants in England and Wales, its Learning and Professional Development Board and its Public Sector Audit Group; the FRC's Audit Technical Advisory Group; CIPFA; HM Treasury's independent Financial Reporting Advisory Board; and INTOSAI. These appointments seek to ensure that the public sector perspective is properly reflected in developments within the accounting and auditing profession.

### KEY FACTS

# 6.5

average number of structured training days undertaken per person

**KEY FACTS****Diversity****45%**

of our people are women

**2.25** Our audit methodology is outlined in our Financial Audit Manual, which is updated regularly. This includes the requirements of the ISAs (UK and Ireland) and provides guidance on interpreting and implementing those standards within the central government sector. Further details on our financial audit methodology and quality assurance processes are included in Appendix Two: Assurance and control.

**2.26** We build quality control into all stages of a financial audit to ensure that the work is of the highest technical quality. We extensively review our work and there are a number of specific review stages. All work undergoes a two-stage review by senior members of the engagement team. Audits that include significant audit judgements (including audits on which the opinion will be qualified) undergo an engagement quality control review by an independent and experienced director. We place a premium on consultation-driven audit quality. Consultation meetings are held at the planning stage of our highest-risk audits and Audit Panels are convened to consider all qualifications, significant audit judgements and C&AG reports. These meetings and panels comprise our senior audit practitioners, senior engagement team members and our director of financial audit practice and quality.

**2.27** In addition, we complete an annual quality assurance programme to make sure that we comply with the Financial Audit Manual and ISQC 1. Our Compliance and Quality Unit, which reports to the chief operating officer, coordinates a programme of hot and cold reviews that are completed before and after an account is certified respectively.

**2.28** The findings of these reviews are largely qualitative and show where audit quality has improved, as well as further areas to address. We communicate areas for improvement to all financial audit staff through regular bulletins, our mandatory annual technical update and, where appropriate, incorporate them into further guidance, training and embed them into our methodology.

**2.29** The internal cold review process undertaken in 2015-16 identified potential improvements to a number of areas. This included the need to document more clearly our assessment and challenge of management's key judgements and assumptions, as well as the need to more explicitly demonstrate compliance with our methodology through improved documentation. The results largely accorded with findings from our external reviewer, the FRC's Audit Quality Review Team.

**2.30** To address these points in 2016 we are undertaking a number of initiatives including root-cause analysis of identified areas for improvement, as well as training and support on thematic issues, including targeted training for those with less experience in supervising or overseeing financial audits, and the need for well-documented audit files. Further details on the review and assurance processes and our actions to address areas of potential improvements to audit quality are set out in Appendix Two: Assurance and control.

**2.31** Audit quality forms a key part of our financial audit performance management framework for individuals. Failings and good practice in audit quality are reflected in the performance assessment of directors and their teams.

## External monitoring for high-quality audit

**2.32** The Practice and Quality Team and the Compliance and Quality Unit consider and report the results of the external monitoring to APQ and to colleagues in the NAO's financial audit and VfM practices. The director of financial audit practice and quality and the director of VfM practice and quality also report annually on the results of the quality assurance processes to the Leadership Team and the Board on key quality issues.

## External monitoring – value-for-money studies 2015-16

**2.33** Each year, external specialists review a sample of published VfM studies. Oxford University Consulting, Risk Solutions and RAND Europe undertake this work. The reviews completed during 2015-16 examined 16 reports. The reviews considered the scope of the study, structure and presentation, graphs and statistics, appropriateness and use of methods, synthesis of VfM conclusions, recommendations, systematic issues and overall perception.

**2.34** Overall reviewers found our reports to be credible, relevant, logically structured, and easy to read. They did, however, note some cases where our findings were less well-synthesised and structured than in previous years. They also judged that some recommendations were not sufficiently specific to be clear how the implementation would lead to public service improvement, and that we did not always fully describe our methodologies. Further details of these monitoring arrangements can be found in Appendix Two: Assurance and control.

## External monitoring – financial audit 2015-16

**2.35** Each year, the FRC's Audit Quality Review Team (AQRT) inspects our work. The FRC's recently published report *Developments in Audit* described its recent inspection:

“As the Independent Supervisor of the Comptroller & Auditor General, the FRC is required under section 1229 of the Companies Act 2006 to supervise the performance of the statutory audit work undertaken by the National Audit Office (NAO), which forms a small part of the NAO's activities. This inspection, which is undertaken annually, comprised the review of two statutory audits together with a review of the NAO's policies and procedures relevant to this audit work. None of the issues raised on either audit were considered to be significant.”

**2.36** The AQRT is required to inspect the work which we complete under the Companies Act and we voluntarily invite it to inspect the work which we complete under statute. In 2015-16, the AQRT reviewed six audits in detail and also undertook follow-up reviews of the NAO's whole-of-office procedures and financial audit methodology.

**2.37** The inspection concluded that the overall quality of the financial audit work was generally of a similar standard to that seen in their previous inspection. The inspection also highlighted areas for further improvement. Further details of these monitoring arrangements, their findings and our responses can be found in Appendix Two: Assurance and control.

# APPENDIX ONE

## GOVERNANCE AND ACCOUNTABILITY

- 1 Effective governance is vital to an organisation's success. We work to practise what we preach by upholding high standards of governance in our operations and decision-making. It is also an essential part of developing and providing our audit programme. The Board supports and advises the Comptroller and Auditor General (C&AG) in meeting his statutory responsibilities, and oversees how we manage and use resources.
- 2 Our governance arrangements are established under the Budget Responsibility and National Audit Act 2011. The arrangements reflect our unique statutory position and Parliament's wish that our governance should independently control and oversee our operations, while preserving the C&AG's independence in giving audit judgements.
- 3 Our Board has a majority of non-executive members including the Chairman. The Public Accounts Commission (PAC) appoints the non-executive members. However, the Chair is appointed by the Queen under letters patent, upon the recommendation of both the Prime Minister and the chair of the Committee of Public Accounts. This ensures that the non-executive members are independent of our management, and have the confidence of the government and the opposition in Parliament. The C&AG has sole preserve of exercising audit judgements and reaching audit opinions.
- 4 The Act also requires that the C&AG, who is appointed by the Queen under letters patent upon the recommendation of the Prime Minister and the chair of the Committee of Public Accounts, sits on the Board, with three other executive members, who are nominated by the C&AG and appointed by the non-executive members.

## NAO BOARD AND LEADERSHIP TEAM



We were very saddened this year by the death of Naaz Coker, who had served on the NAO Board since July 2012. Naaz was exceptionally

talented, as reflected in her many achievements, which included Asian Woman of the Year in 2000 and 2003. In her time on our Board, Naaz contributed much to the organisation and in particular provided valuable advice and advocacy to help the NAO drive forward its approach to diversity and inclusion. She was also the NAO's Senior Independent Director. Naaz is greatly missed by all those with whom she worked at the NAO.

### Key to committee membership

- NAO board
- Audit Committee
- Remuneration and Nominations Committee
- Leadership Team
- Operational Capability Committee
- Audit Practice and Quality Committee
- Change Management and Assurance Committee

### 1 Lord (Michael) Bichard KCB

#### Chairman of the NAO Board

Lord Bichard has served at very senior levels in local government as Chief Executive at both Brent and Gloucestershire. He then moved into central government working as Chief Executive of the Benefits Agency and then as Permanent Secretary at the Department for Education and Employment. Since his retirement from the Civil Service in 2001, he has held a variety of posts including Vice Chancellor of the University of the Arts London, Chair of the Legal Services Commission, Chair of the Design Council and was the founder Director of the Institute for Government. In 2004 he chaired an inquiry into the Soham murders. He is currently Chair of the Social Care Institute for Excellence and Deputy Chair of Shakespeare's Globe. He received a knighthood in 1999 and became a cross-bench member of the House of Lords in 2010. He is now a Deputy Speaker of the House.



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### 2 Sir Amyas Morse KCB

#### Comptroller and Auditor General and NAO Board member

Sir Amyas Morse was appointed C&AG on 1 June 2009, and is a member of the Institute of Chartered Accountants of Scotland. Amyas was Global Managing Partner (Operations) at PricewaterhouseCoopers before he joined the Ministry of Defence in 2006 as Commercial Director. He has served as a member of the Major Projects Review Group and the Public Sector Board of the Chartered Institute of Purchasing and Supply, and on a National Health Service Project Board.

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### 3 Michael Whitehouse OBE

#### **Chief Operating Officer and NAO Board member**

Michael Whitehouse was appointed Chief Operating Officer in July 2009. Michael is a qualified accountant with extensive experience of value-for-money work across government and internationally. Michael has responsibility for the strategy, capability and operational performance of the NAO, and leads the NAO's work on cross-government issues. Michael is Chair of the Operational Capability Committee and the Change Management and Assurance Committee.

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### 4 Sue Higgins

#### **Executive Leader and Executive Board member (until June 2016)**

Sue Higgins joined the NAO in January 2014 as an Executive Leader. She is responsible for the NAO's work on local government, health and education. Sue joined the NAO from the Department for Communities and Local Government where she was Director General, Finance & Corporate Services. Prior to this, Sue held the same role in the Department for Education having moved from the local government sector in 2009. She is a qualified accountant. Sue served as an executive member of the NAO Board for 2015-16. Sue has made a significant contribution to the NAO through her work on transitioning Audit Commission people and functions and building our profile with local bodies. Sue also led the design of our new approach to performance assessment and development. Sue left the NAO at the end of June 2016 to take up the role of Auditor General of the Cayman Islands.

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### 5 Dr Sally Howes OBE

#### **Executive Leader and Executive Board member (until Summer 2016)**

Sally Howes joined the NAO in April 2010 as a Director and was appointed as an Executive Leader in April 2013. For more than six years, Sally has used her experience of policy, strategy, software and systems development to guide the introduction of new approaches to learning, development and knowledge management and championed our communities of practice. Sally served as an executive member of the NAO Board for 2015-16 and has made an important contribution in ensuring that the NAO is recognised as a thought leader in the digital challenges which government faces. Sally has decided to leave the NAO in the summer to return to the technology sector.

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### 6 Joanne Shaw

#### **Non-executive member of the NAO Board and Chair of the Audit Committee**

Joanne Shaw is an experienced non-executive director and board chair with a background in private, public and third-sector organisations. She is a qualified accountant with expertise in strategic development and change management. More recently, she served as non-executive Chair of NHS Direct, and is currently on the board of the British Board of Film Classification and two healthcare organisations, Nuffield Health and Datapharm Communications Limited. She is the chair of our Audit Committee, a post she has held since joining the board in January 2015.

## 7 Ray Shostak CBE

### Non-executive member of the NAO Board and Chair of the Remuneration and Nominations Committee

Ray Shostak is an international adviser in education, government performance and public service reform. He has held a number of positions in local and central government including Head of the Prime Minister's Delivery Unit and was a member of the Board of HM Treasury from 2007 to 2011. Ray is currently Chair of Trustees of the Consortium of Voluntary Adoption Agencies, a Trustee of the Early Intervention Foundation and is an Honorary Norham Fellow at Oxford University. He has been chair of the Remuneration and Nominations Committee since January 2015.

## 8 Robert Sykes

### Non-executive member of the NAO Board (from January 2015)

Robert Sykes has significant experience of working in local government, and served as Chief Executive of Worcestershire County Council for 10 years. He also has non-executive experience in the private and public sectors, most recently serving on the Boards of Core Assets and as non-executive member of the Board of the Crown Prosecution Service until 2012. In 2012, the Secretary of State for Communities and Local Government appointed him as Lead Commissioner at Doncaster MBC. He stepped down in the summer of 2014 when the intervention successfully ended.

Rob Sykes serves as the Senior Independent Director to the NAO.

## 9 Martin Sinclair

### Executive Leader (to September 2015)

Martin Sinclair left the NAO in September 2015 having been an Executive Leader (Assistant Auditor General) since 1999. He was responsible for the audit of a broad portfolio of clients, including many major government departments. He is a member of the Council of the Chartered Institute of Public Finance and Accountancy (CIPFA) and is Chair of CIPFA's Remuneration Committee. Martin was Chair of the Audit Practice and Quality Committee.

## 10 Gabrielle Cohen

### Executive Leader and Executive Board member (to April 2015)

Gabrielle Cohen left the NAO in April 2015 having been an Executive Leader (Assistant Auditor General) from 2005 to 2015. She trained as an accountant with the NAO and was appointed to the Board in July 2009. During 2014-15, Gabrielle was responsible for leading our stakeholder relations, governance, corporate policy and relations with Parliament.

## 11 Stephen Smith

### Executive Leader and Senior Audit Practitioner (from August 2015)

Stephen Smith joined the NAO in August 2015, as an Executive Leader. Prior to that, he had over 20 years experience as a Partner with KPMG, where he led a number of initiatives for the firm nationally and internationally. His experience ranges across a broad spectrum, including audit, mergers and acquisitions, and business advice, as well as a secondment to HM Treasury Accounting Group. Stephen is jointly responsible for leadership of the financial audit workstream, a portfolio of public sector bodies and, more generally, the NAO's corporate finance related work.

## 12 John Thorpe

### Executive Leader, NAO Board member and Senior Audit Practitioner

John Thorpe joined the NAO in 1983 as a trainee, becoming a Lead Director, and joining the Leadership Team in January 2014. He has experience directing a mixed portfolio of work, providing leadership to the financial audit workstream and achieving significant progress in key areas – such as the review of HM Revenue & Customs' compliance and enforcement programme, and tax credits fraud and error. John stepped down from the Board at the end of March 2015, as part of a rotation of executive members. John is Chair of the Audit Practice and Quality Committee following Martin Sinclair's departure.



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5 The Board is supported by two committees, both of which consist solely of non-executive members.

### Audit Committee

- The Committee supports the Board by reviewing our internal controls, risk management processes and governance arrangements, as well as the quality and reliability of our financial reporting. It also considers the external auditor's annual value-for-money report on the NAO.

### Remuneration and Nominations Committee

- The Committee determines the framework for remunerating the three executive members of the Board. It also oversees any major changes in employee benefits. Parliament sets the C&AG's remuneration. The Committee also advises the Chair and the C&AG on succession planning for the leadership team and Board.

6 There is a clear division of responsibility between the Chairman and the C&AG. The Chairman is responsible for leading, and effective working of, the Board. The C&AG is responsible for implementing the strategy, making audit judgements, deciding a programme of value-for-money examinations and reporting the results to Parliament.

7 The relationship between the Board and the C&AG is set out in more detail in our Code of Practice.<sup>2</sup> The Board supports and challenges improvements in our operations. Members give additional rigour and discipline to decision-making and bring insight from their wider experience to inform our thinking and support improvement.

8 The Board met formally seven times during 2015-16 to discharge its responsibilities, which are set out in the Act and complement the C&AG's responsibilities. The Board attended two Strategy Days in the year, to focus on the NAO's strategic objectives and progress against strategy. The Board also held a workshop to consider the NAO's approach to the management and development of its people. Each year the C&AG and NAO Board agree the NAO Strategy and an estimate of resources required for each financial year, which are submitted to the PAC for consideration and approval. The NAO Board and C&AG also prepare an annual report on our activities, which includes our annual resource accounts. The Board must also recommend the external auditor for appointment by the PAC.

2 National Audit Office, *The NAO Code of Practice*, March 2012. Available at: [www.nao.org.uk/freedom-of-information/wp-content/uploads/sites/13/2013/03/Code\\_of\\_Practice\\_Spring\\_2012.pdf](http://www.nao.org.uk/freedom-of-information/wp-content/uploads/sites/13/2013/03/Code_of_Practice_Spring_2012.pdf)

**9** The Board is responsible for the programme of work undertaken outside of the C&AG's statutory responsibilities. This programme of work includes those financial audits undertaken under the Companies Act 2006, the value-for-money review of the BBC, and our work with international organisations such as the United Nations. It approves this programme of work and the resources required annually.

**10** The NAO Board undertakes a review of its performance each year. During 2015-16, due to the recent changes in the composition of the Board, the Chair elected to undertake this review internally, based on conversations with Board members, and informed by an internal audit report on the recent induction of the three new non-executive members. This review concluded that it was too early in the tenures of the new members, both executive and non-executive, to identify any formal areas for action, and members agreed to revisit this issue once the non-executive members had served for a full year. The review did identify an early opportunity to better support non-executive members in engaging with the business outside of the formal Board programme.

**11** The C&AG is supported in his role by the Leadership Team. The Leadership Team helps the C&AG to develop and implement strategy, lead staff, set work priorities, monitor performance and manage risk.

**12** The NAO is accountable to Parliament, via the PAC. The PAC's role is defined by both the National Audit Act 1983 and the Budget Responsibility and National Audit Act 2011. The Commission's principal duties under the acts are to examine the NAO Estimate and lay it before Parliament, to consider our strategy, to appoint our auditor and receive its reports, to appoint non-executive members of the Board, and to report from time to time.

**13** Our formal governance structure is as follows:

## National Audit Office governance structure

### The Public Accounts Commission

Is formally responsible for: the approval of the NAO's strategy and setting the NAO's budget; the appointment of the non-executive members of the NAO Board; and the appointment of the NAO's external auditor.

### NAO Board

The role of the Board is to:

- develop the NAO's strategy with the C&AG;
- provide oversight of the management of NAO's resource; and
- support and advise the C&AG in the exercise of his functions.

### Leadership Team

The C&AG is supported in his role by a Leadership Team which:

- provides executive management; and
- provides governance to the operations delivery of the NAO.

The team is chaired by the C&AG and includes the chief operating officer and the four executive leaders.

### Remuneration and Nominations Committee

The Committee is responsible for:

- determining the framework for the remuneration of the three executive members of the Board;
- overseeing major changes in NAO employee benefits; and
- the remuneration of the executive members of the Board.

### Audit Committee

The Committee supports the Board by:

- reviewing the internal controls;
- reviewing risk management processes;
- reviewing governance arrangements of the NAO; and
- reviewing the quality and reliability of financial reporting.

### Audit Practice Quality Committee

The Committee exists to review the comprehensiveness, reliability and integrity of the framework supporting the technical quality of the NAO's audit work.

### Operational Capability Committee

The Committee's function is to:

- support the Leadership Team in delivering appropriate resources; and
- support the NAO in achieving its business objectives.

### Change Management and Assurance Committee

The Committee works to oversee the corporate change portfolio and provide advice and assurance to the Leadership Team on the portfolio and, where appropriate, individual projects.

## Review of effectiveness

**14** The C&AG's review of effectiveness of the system of internal control is informed by the work of the director of internal audit and assurance, the executive leaders within the NAO who have responsibility for the development and maintenance of the internal control framework, comments made by the external auditors in their management letter and other reports. The director of internal audit and assurance (DIAA) has presented to the C&AG his Internal Audit Annual Report, which concludes: "The NAO has adequate and effective governance, risk and control arrangements." He has arrived at this opinion through:

- conducting a detailed risk-based Internal Audit Needs Assessment from which he has prioritised activity over a three-year planning horizon to design an Internal Audit Strategy;
- designing and populating a three-lines-of-defence model to provide a 'birds eye' view of the assurance framework received by both the Leadership Team and the Audit Committee;
- designing and applying a risk-based methodology which is consistent with the requirements of the Public Sector Internal Audit Standards;
- delivery of 24 individual assurance reports and eight advisory reports during the year and where appropriate agreed an action plan with system owners to secure improvements; and
- monitoring the implementation of these recommendations throughout the year and assessed the progress as good.

**15** The C&AG is able to report that there were no significant weaknesses in the NAO's system of internal controls in 2015-16 that affected the achievements of the NAO's key policies, aims and objectives.

## Structure

**16** Our strategy is to use the insights we derive as the government's external auditors to help improve public services. The NAO is organised into clusters, which group teams working on clients with common strategic issues. By organising ourselves in this way, we can be more effective at sharing our knowledge and developing deep expertise in these strategic issues, to benefit the government and Parliament. The six clusters are:

## Our clusters and their objectives



Cluster	Departments	Objective
Delivering Major Programmes	Department of Energy & Climate Change; Ministry of Defence; Department for Transport;	Improving the effective delivery of major programmes and projects
Local Service Delivery and User Experience	Department for Communities and Local Government; Department of Health	Maintaining effective local services under financial constraint
Influencing and Regulating	Department for Business, Innovation & Skills; Department for Environment, Food & Rural Affairs; Department for International Development; Foreign & Commonwealth Office	Strengthening influence and regulation to make markets work effectively
Delivery through Networks	Department for Culture, Media & Sport; Department for Education; Home Office; Ministry of Justice	Improving outcomes from a diverse range of providers, with effective oversight and intervention
Effective Strategic Centre	Cabinet Office; HM Treasury; Parliament	Securing an effective centre of government that facilitates the best use of public money
Mass Market Operations	Department for Work & Pensions; HM Revenue & Customs; International	Improving the accuracy and effectiveness of high-volume services to the public

**17** We have a core investigations team who focus on matters of irregularity and responding to concerns raised by Parliament and the public.

**18** We also benefit from communities of practice. A community of practice is a group of people with common experience, expertise and interest in a topic that works across the clusters and NAO to:

- share experience, methods and expertise freely and willingly, to avoid duplication and improve operational effectiveness;
- develop and deploy the right skills, to the right depth, in the right places at the right time; and
- helps the NAO provide an authoritative voice in areas of strategic interest.

**19** We have six communities of practice which include various specialist disciplines:

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## Communities of practice within the NAO

### **MESH (Methods, Economics and Statistics Hub)**

#### **Commercial and Contracting**

#### **Corporate finance**

#### **Digital**

#### **Operations and process management**

#### **Project and programme delivery**

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## People

**20** We employed an average of 796 full-time equivalent staff during 2015-16. Most of our front-line staff are qualified or trainee accountants with the main accountancy institutes. This expertise is supported by other staff with specialisms in areas such as economics, statistics and information technology.

**21** We are a registered trainer for the Institute of Chartered Accountants in England and Wales (ICAEW). We recruit and train approximately 70 trainees a year, who undertake structured training towards becoming chartered accountants through ICAEW.

**22** We give all staff suitable training for continual professional development. In addition to our flexible and efficient online and e-learning tools, we have development programmes for high-potential staff to prepare them for future leadership positions. The Emerging Leaders programme is aimed at those at an earlier stage in their career. The Leaders programme is aimed at managers with the potential to become directors.

**23** Continual staff development is also supported by a programme of staff secondments to government bodies and private sector organisations. This is valuable in increasing insight into how the government works, developing operational experience and helping to form useful and practical recommendations for our reports. We take care when redeploying staff on return, to avoid conflicts of interests and to make best use of the skills they have learned.

**24** We publish an organisation chart showing our structure and leaderships' responsibilities on our [website](#). In 2015-16, the staff distribution by grade and gender for all staff in post (as opposed to full-time equivalent) was as follows:

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### Staff distribution

Grade	Percentage	Female	Male
Leadership	1%	40%	60%
Director	6%	25%	75%
Manager	17%	42%	58%
Lead	32%	48%	52%
Trainees	29%	41%	59%
Corporate services	15%	60%	40%
Total staff mix	100%	45%	55%

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**25** We conduct an annual survey to understand staff opinions on a range of work-related issues and we benchmark the results against public and private sector norms. Our 2015 survey shows continued improvement in a number of areas, with 85% of respondents saying they are interested in their work, 90% of people having a clear understanding of the NAO's purpose and 82% of people feeling their manager is open to their ideas.

**26** We give staff suitable training opportunities to ensure continual professional development, and use clear objectives to measure their performance. Increases in base pay are directly linked to performance and all staff must agree specific development objectives focused on further improving their performance and skills.

**27** We are independent of government pay policy, although we take HM Treasury guidance and the wider public sector pay environment into account in considering our own approach to pay. Performance-related increases focus solely on base pay and there is no system of bonuses. In addition to salary, the largest non-pay benefit (along with our investment in training) is the civil service pension scheme.

## Financial information

**28** We are conscious of the need to practise what we preach on financial management and value for money. Each year the NAO's external auditor undertakes a value-for-money review of a specific aspect of the NAO's operation. In 2015-16, this review looked at the NAO's Human Resources function. The review concluded that while the NAO's Human Resources team was larger than that typically found in similar sized professional firms, the relatively wide scope of the team's activities needed to be recognised when making such a comparison. It made six recommendations, all of which have been accepted and are being implemented by the NAO's executive management and have informed a recent review of the NAO's corporate services to identify further efficiencies and cost savings within our cost base.

**29** Our full financial information is contained in our [Annual Report and Accounts 2015-16](#), which can be found on our website.

**30** Our Annual Report contains a detailed remuneration report. We also publish details of senior staff remuneration and Leadership Team and Board members' travel and subsistence costs and hospitality they provide and receive. Details can be found on our website: [www.nao.org.uk/about-us/our-work/governance-of-the-nao/transparency/](http://www.nao.org.uk/about-us/our-work/governance-of-the-nao/transparency/)

## National Audit Office operating segments

	2015-16								
	Financial audit £000	Value for money £000	Investigations and insight £000	Support to Parliament £000	International relations £000	Comptroller function £000	Voted £000	Non-voted £000	Total £000
Gross expenditure	49,490	16,932	10,303	4,925	1,367	204	83,221	289	<b>83,510</b>
Income from services provided	(16,330)	–	–	(613)	(581)	–	(17,524)	–	<b>(17,524)</b>
Rental income	(1,063)	(364)	(221)	(107)	(29)	(4)	(1,788)	–	<b>(1,788)</b>
<b>Net expenditure</b>	<b>32,097</b>	<b>16,568</b>	<b>10,082</b>	<b>4,205</b>	<b>757</b>	<b>200</b>	<b>63,909</b>	<b>289</b>	<b>64,198</b>

	2014-15								
	Financial audit £000	Value for money £000	Investigations and insight £000	Support to Parliament £000	International relations £000	Comptroller function £000	Voted £000	Non-voted £000	Total £000
Gross expenditure	49,219	16,643	9,520	5,342	1,750	200	82,674	297	<b>82,971</b>
Income from services provided	(18,061)	–	–	(958)	(678)	–	(19,697)	–	<b>(19,697)</b>
Rental income	(995)	(336)	(192)	(108)	(35)	(4)	(1,670)	–	<b>(1,670)</b>
<b>Net expenditure</b>	<b>30,163</b>	<b>16,307</b>	<b>9,328</b>	<b>4,276</b>	<b>1,037</b>	<b>196</b>	<b>61,307</b>	<b>297</b>	<b>61,604</b>

The NAO reports expenditure and income on its provision of Audit and Other Assurance Services under six operating segments, more information on these can be found in the Performance Report within the Annual Report and Accounts. Included in the financial audit operating segment is international audit work with a gross expenditure of £2.7 million and income of £2.8 million.

Non-Voted expenditure includes the C&AG's and Chairman's salaries and is paid directly from the Consolidated Fund, which is outside of the control of the NAO.

Income from services includes fees charged on UK and international audits, costs recovered on the NAO's outward secondment programme to support Parliament and other government bodies, and fees charged for some of the NAO's international relations and overseas capacity-building work.

Rental income cannot be directly attributed to the NAO's operating segments and has been apportioned.

# APPENDIX TWO

## ASSURANCE AND CONTROL

The NAO has robust assurance and control procedures in place to ensure all our outputs meet the high standards expected by our stakeholders.

## Financial Audit

**1** Most of the C&AG's audits are by statutory appointment, so he cannot withdraw or decline them. However, the C&AG can report to Parliament on matters that might otherwise have caused him to withdraw from the engagement. No such instances arose during 2015-16.

**2** Where the C&AG is appointed as auditor other than by statutory appointment, the NAO Board agrees and approves the work programme and resources used. The C&AG must be confident that the terms and scope of the work are appropriate and that there are adequate resources. He has sole responsibility for audit judgements and conclusions reached, including the right to decline or withdraw from any of these engagements. He is advised by the relevant engagement director, senior audit practitioners and the director of financial audit practice and quality in engagement acceptance matters.

**3** Each year the risks associated with an audit will change and therefore we consider annually our appointment. These issues include the integrity and competence of the client's board members and senior managers as well as the specific audit team's competence. Our procedures are designed to ensure that the team meets the ethical and professional requirements that we and the auditing profession stipulate.

### Policies and procedures

**4** The director of financial audit practice and quality issues the Financial Audit Manual, and this is the main reference source for audit policy and guidance. It sets out the requirements of International Standards on Auditing (UK and Ireland) and how we must apply these. The manual is updated regularly, to incorporate any changes to professional standards and internal policy changes which the leadership team agrees.

**5** Our audit methodology, as set out in the Financial Audit Manual, is integrated with the software package we use to document audit work. The software, along with other tools and templates, make it straightforward for engagement teams to comply with standards and internal policy. They also encourage efficient working by increasing standardisation and reducing the need for teams to recreate standard audit approaches. The audit approach is codified in centrally defined work programmes with customisation requiring central approval.

### Control framework

**6** Overall responsibility for a financial audit rests with the engagement director. We use a two-stage internal review process for audits to ensure the quality of financial audit work:

**First stage review**

- A senior member of the engagement team reviews all audit tests and supporting working papers, focusing on audit quality.

**Second stage review**

- The engagement director performs a second review to confirm that sufficient and appropriate evidence has been obtained to support the recommended audit opinion. This review focuses on the risks of material misstatement and key judgements made by the engagement team.

**7** Where an engagement director identifies a matter that involves significant professional judgement, they must consult the Practice and Quality Team, which is led by the director of financial audit practice and quality before concluding on that matter.

**8** The most significant technical issues will be considered by an audit panel. Panels are convened to give the C&AG advice on specific issues as these arise. The panel may include the C&AG and chief operating officer, and will include one or both of the senior audit practitioners, the director of financial audit practice and quality, and senior engagement team members.

**9** Some engagements are assigned an engagement quality control reviewer (EQCR), who is an experienced financial audit director independent from the engagement team. The EQCR's role is primarily to challenge key audit judgements and review evidence supporting the engagement team's conclusions on significant matters. EQCRs are assigned to most audits where a qualification of the audit opinion seems likely or where the audit risk is particularly high.

**10** Our internal Compliance and Quality Unit reviews the files of certain audits (mainly those that are high risk) at the planning stage and before the audit report is issued ('hot reviews'). These reviews focus on the evidence to support conclusions on each of the significant audit risks, the work performed on material audit areas and compliance with the ISAs in key areas.

**11** The Compliance and Quality Unit also reviews the audit files of a sample of completed audits each year. Coverage is obtained over all financial audit directors at least every two years. Their purpose is to assess:

- the audit's compliance with professional standards and our audit policy, including reviewing the planned response and work completed to address the main risks;
- the quality of evidence the team collected to support the main audit risks; and
- any opportunities to improve documentation and make efficiencies in the audit approach for the following audit cycle.

## Training and technical competence

### Training

**12** Supporting the professional accountancy training received by all trainee auditors, the director of financial audit practice and quality ensures appropriate in-house training relevant to financial audit staff.

**13** Staff working towards an accountancy qualification are required to participate in practical audit training, which provides real-life audit scenarios. This helps to embed our audit methodology and encourages a sceptical approach to audit evidence.

**14** As part of their annual continual professional development (CPD) requirement, qualified staff must attend an annual technical update session each year. This covers:

- financial reporting developments;
- auditing developments including ethics and changes to our audit methodology;
- reminders on obligations regarding money laundering; and
- findings from the quality assurance process, with priorities for improving audit quality.

**15** All financial audit staff have access to a wide range of financial audit training, which can be selected based on the individual's role and prior experience. For example, in 2015-16 targeted training was provided in the following areas:

- the auditing of journals;
- the auditing of defined pensions;
- the auditing of significant estimates; and
- group audits.

**16** We developed a skills strategy to ensure that we continue to develop the skills to meet the needs of our new assurance products. Within the NAO, we employ a role-based approach, where a colleague's grade is less important than the role they play, which is based on experience and ability. This approach allows colleagues to gain valuable experience of working in a more stretching role to support their career development. We have also developed a variety of learning and development options specifically to assist those new to the engagement manager and engagement director roles.

### Audit licences

**17** Individuals supervising, managing or directing a financial audit will usually hold the relevant audit licence. The director of financial audit practice and quality usually grants audit licences to all staff who:

- have an appropriate level of recent financial audit experience;
- have an appropriate level of CPD in the previous year;
- have signed the NAO's Code of Conduct; and
- are Consultative Committee of Accountancy Bodies (CCAB)-qualified or exam-qualified.

**18** The director of financial audit practice and quality awards specialist licences to staff whose work involves complex IT systems, the audit of companies, pension schemes, charities and accounts prepared under International Public Sector Accounting Standards. All staff holding a specialist licence must also hold a general audit licence, have an appropriate level of recent experience in the specialist area and have attended relevant technical updates.

**19** Members of staff who do not hold the appropriate licence can hold senior roles within the engagement team, provided supervision arrangements are put in place. For example, a pension scheme audit where neither the engagement director nor engagement manager holds a pensions licence will be assigned a second director who does hold a pensions licence. The engagement director must consult with the second director at regular points during the audit, and before issuing the audit report.

## Value for money

**20** Core policies and procedures for value-for-money (VfM) work are set out in our VfM guidance. The guidance describes our approach to VfM audit, so that we can meet our objectives of providing independent analysis and assurance to Parliament on how public money has been spent, and make recommendations that lead directly to service improvements. The guidance is held electronically and updated whenever a change is made to VfM arrangements. It contains detailed guidance relating to specific stages in the lifecycle of a VfM study, and analytical and technical guidance on VfM methods and approaches.

**21** These policies and procedures are underpinned by the NAO's VfM and non-financial audit standards, which set out the expectations that all VfM studies and other major non-financial audit outputs must meet. Colleagues working on VfM products are expected to adhere to the standards and this is considered as part of the internal quality assurance arrangements. There are 12 standards covering:

- integrity, objectivity and independence;
- work proposal and selection;
- design and planning;
- evidence and analysis;
- forming conclusions and recommendations;
- reporting;
- quality assurance;
- project management and monitoring;
- engagement with audited bodies;
- engagement with other stakeholders;
- achieving impact; and
- learning lessons and sharing knowledge.

## Control framework

**22** Directors ensure that there are proportionate and appropriate quality assurance arrangements for their studies. We assign each VfM study a partner director and case manager. The partner director acts as a constructive critic and the case manager is available to provide technical and practical advice and guidance throughout the study. The quality of our VfM work is controlled using the following mandatory framework:

- Study and product selection. The C&AG and leadership team select VfM studies after information gathering, proposal development and review, to ensure proposals fit with our objectives and Parliament's needs.
- Approving the study concept. The C&AG examines and approves a study concept, considering the rationale, scope, product type and strategic fit of proposed studies.
- Budget approval. Clusters scrutinise and approve study budgets after the C&AG has agreed the scope.
- Proof-of-concept meeting. When most of the fieldwork has been completed, the C&AG challenges the study team on how the evidence collected supports the logic of the intended report.
- C&AG review. The C&AG reviews the draft provisional audit findings and the draft final report. Once he is content, the team sends the draft to the audited body for consideration and comment.
- Copy editor and data presentation review. The copy editor edits the draft report before publication. This is designed to confirm adherence to our publication standards and readability.
- Optional quality assurance. A range of additional quality assurance is available for teams, including reviews of the draft report, methods-specific quality assurance, and external advice or consultancy.
- Post-project review. After we publish the report, the study team reviews the conduct of the study to identify examples of good practice and lessons learnt, which they disseminate across the organisation.
- Internal cold review. A sample of around 10 audits each year are peer-reviewed against a standard set of criteria to identify how well they have met the VfM standards. Each VfM team is examined regularly. An experienced director and manager independent of the team conduct the reviews, and they gather evidence to reach a judgement on whether the standards have been met.
- External cold review. A sample of published VfM reports (16 in 2015-16) are subject to an independent, external review. The reviewer considers the report against a set of agreed criteria.

## Training and technical competence

**23** VfM staff are qualified accountants (or training in accountancy) or specialists qualified in other disciplines such as economics, statistics, social research and operational research. To maintain the technical competence of our VfM staff, we give a full and varied training programme, ranging from introductory courses for trainees and new analysts to technical courses for experienced practitioners.

**24** Courses for trainees include among other things:

- an introduction to assurance methods (incorporating both financial audit and VfM methodology);
- interview techniques; and
- statistics and research methods.

**25** Trainees also gain experience of VfM audit by working on studies alongside financial audit training. We fund more complex technical courses run by external training providers and specialists where appropriate.

**26** We have put together a two-year programme that is designed to support audit principals and senior analysts moving into more of a lead role on audit engagements. This is in response to feedback from trainees that commented on the shift from a three-year training programme to support them before they qualified to a post-qualification situation where there was no set learning and development framework. This programme consists of existing learning and development offerings but placed in a structured two-year context. It includes elements such as essential skills for new managers, workshops, opportunities to develop other non-audit skills that will help colleagues get better at their job, and more opportunities for collaboration across VfM and financial audit disciplines.

**27** We provide formal one-to-one coaching for people who wish to explore and address underperformance across any aspect of their work.

**28** From November 2016 we will be rolling out a training course to everyone in the organisation. The five-day, three-module programme aims to build on the current strengths we have and empower people even more, so they feel more confident to contribute to our work and ultimately help us to bring the best the NAO has to all of our work. Teams will attend these modules over a two-year period. Throughout this time, learning and behaviour change will be embedded through peer coaching, team coaching, supplementary learning and development materials and optional team activities.

## External monitoring

### External review – financial audit

**29** The Audit Quality Review Team (AQRT) of the Financial Reporting Council (FRC) reviews a selection of audit files. In 2015-16, the AQRT reviewed six completed audit files (2014-15: six), of which two (2014-15: two) were performed under the Companies Act 2006. We responded to their findings.

**30** The AQRT also carried out a follow-up review of our policies, processes and procedures supporting financial audit quality. The inspection considered the actions taken on findings arising from the 2014-15 inspection. This considered methodology, related training (including training in relation to IT audit) and guidance.

**31** The inspection concluded that the overall quality of the financial audit work was generally of a similar standard to that seen in their previous inspection. The inspection highlighted areas for further improvement. These included: challenge of management in relation to areas of judgement, in particular key assumptions used in valuations and estimates; testing of controls; performance of analytical procedures; and review of accounts disclosures and reporting to audit committees.

**32** To address these points, we have:

- communicated the AQRT's findings to all staff and incorporated the feedback into our annual assurance training;
- held detailed discussions of AQRT findings with directors and managers in group meetings;
- enhanced our mandatory consultation procedures for our highest-risk audits;
- updated our standard audit documentation templates and guidance, which includes the further integration of our audit work surrounding IT systems (including placing reliance on information provided by the entity);
- continued our training programme to support our staff in auditing complex IT environments while promoting the skillset of Certified Information Systems Auditor (CISA) qualified auditors to provide guidance and support;
- provided mandatory training to all engagement quality control reviewer (EQCR) directors to ensure that they adopt a consistent approach in undertaking and documenting their role;
- re-emphasised the importance of embedding our consideration of risk throughout the audit via office-wide annual technical updates; and
- provided additional training for engagement managers and engagement directors where they are adopting that role for the first time.

**33** We are continuing to develop and enhance our IT audit capability. In 2016, we appointed a director of information assurance in response to previous AQRT findings surrounding the documented consideration of audit risk, particularly with respect to the IT environment.

**34** The AQRT has highlighted that our secondments policy does not reflect the requirements of the Ethical Standards. We continue to engage with the FRC on this matter. Following consultation on and revision of the Ethical Standards, the NAO will be reviewing all policies relating to ethics.

### External review – VfM reports

**35** For 22 years we have used external specialists to review VfM reports. In 2015-16, a sample of our reports were reviewed by independent experts from Oxford University Consulting, Risk Solutions and RAND Europe.

**36** Our reviewers assess the report against a set of criteria:

- Scope
- Structure and presentation
- Graphics and statistics
- Appropriateness and use of methods
- Synthesis of VfM conclusions, recommendations, systemic issues
- Overall perception

**37** They provide a written review assessing how each report performs against the criteria in paragraph 36, including an overall assessment. The reviewers have also reported on specific themes such as the quality of drafting and how we use evidence. The Audit Practice Quality Committee uses these reviews as the basis of discussions on quality.

**38** Our central Practice and Quality Team also seeks formal feedback from clients on individual studies, including the conduct of the study, whether the study was of high technical quality, our staff's professionalism, engagement with the client and knowledge of the team. Our surveys are conducted electronically and are sent to the appropriate senior working-level contacts for each report at the audited body. This gives us better and timely feedback.

# APPENDIX THREE

## TRANSPARENCY REPORT DISCLOSURE REQUIREMENTS

The table below shows where the disclosures required by The Statutory Auditors (Transparency) Instrument 2008 can be found in this Transparency Report.

Provision of the Instrument	How the National Audit Office complies with the Instrument
A description of the legal structure and ownership of the transparency reporting auditor.	See Appendix One, Governance and accountability
Where the transparency reporting auditor belongs to a network, a description of the network and the legal and structural arrangements of the network.	Not applicable to the National Audit Office.
A description of the governance structure of the transparency reporting auditor.	See Appendix One, Governance and accountability
A description of the internal quality control system of the transparency reporting auditor and a statement by the administrative or management body on the effectiveness of its functioning.	See Part Two for the internal quality control system and Appendix One for Board effectiveness
A statement of when the last monitoring of the performance by the transparency reporting auditor of statutory audit functions within the meaning of paragraph 13 of Schedule 10 to the Act (as amended by regulation 23 of the Statutory Auditors and Third Country Auditors Regulations 2007 (S.I. 2007/3494)) took place.	See Part Two, High-quality engagement performance section
A list of public interest entities in respect of which an audit report has been made by the transparency reporting auditor in the financial year of the auditor; and any such list may be made available elsewhere on the website specified in regulation 4 provided that a clear link is established between the transparency report and such a list.	In 2015-16, the NAO did not audit any public interest entity
A description of the transparency reporting auditor's independence procedures and practices including a confirmation that an internal review of independence practices has been conducted.	See Part Two, Independence section
A statement on the policies and practices of the transparency reporting auditor designed to ensure that persons eligible for appointment as a statutory auditor continue to maintain their theoretical knowledge, professional skills and values at a sufficiently high level.	See Part Two, Our People section
Financial information for the financial year of the transparency reporting auditor to which the report relates, including the showing of the importance of the transparency reporting auditor's statutory audit work.	See Appendix One, Financial information section
Information about the basis for the remuneration of partners.	See Appendix One, Governance and accountability



National Audit Office

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