



National Audit Office

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National Audit Office

# Transparency Report 2015

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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, which employs some 810 people. 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 £1.15 billion in 2014.

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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), made by the former Professional Oversight Board (POB) of the Financial Reporting Council. Although the Instrument does not cover our work, we choose to produce our own transparency report to comply with best practice. The board endorsed this report on 22 October 2015.

# Foreword

## From the Comptroller and Auditor General

My role is to give Parliament assurance about how public money is spent and I am supported by the National Audit Office (NAO), as Comptroller and Auditor General (C&AG). Of course, it is right that Parliament will ask questions of me about how we fulfil that role.

In our strategy we set out our intentions to keep the NAO in a position to be highly effective on a sustained basis, constantly adapting and improving our contribution and its relevance to Parliament and to Government. At the same time we continue to reduce our costs, increase our influence and maintain the quality of our outputs.

Our Annual Report for 2014-15 set out the continued considerable progress we have made against this strategy. This Transparency Report complements our Annual Report by focussing on how we have ensured that our audit work meets the highest professional standards expected of us and ensured that we remain accountable to Parliament.

We see from our audit work that transparency is vital to maintaining quality and stakeholder confidence and the same applies to us. Therefore, I am pleased to report back 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



“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.”

**Michael Whitehouse**  
Chief Operating Officer

## Comptroller and Auditor General

**1.1** The Comptroller and Auditor General (C&AG) is appointed by the Queen as an Officer of the House of Commons. He is appointed for a single non-renewable term of ten 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 Chief Executive Officer 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, 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. We certified 401 accounts in respect of the 2014-15 accounting period with expenditure and revenue amounting to more than £1 trillion.

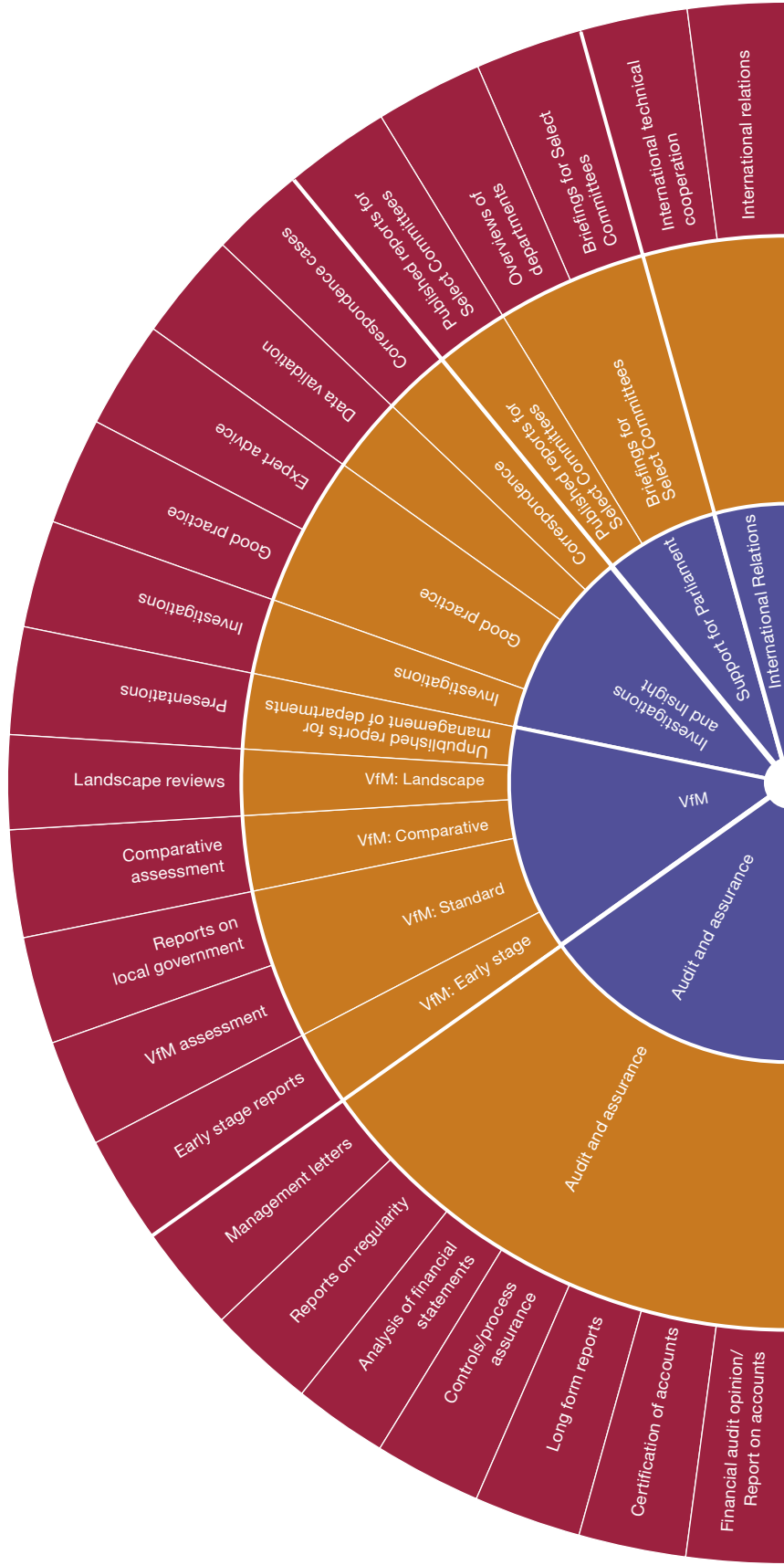
**1.7** We also examine particular areas of central government expenditure to establish whether public funds have been used economically, efficiently and effectively and report the outcome to Parliament. This strand of our work is called 'value for money (VfM) audit'. In 2014-15, we published 49 VfM reports on key government initiatives and the current challenges government faces. We developed our investigative capacity and capability, and in 2014-15 we completed 13 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 £630m to achieve validated savings to government of

**£1.15bn**

National Audit Office assurance products



- National Audit Office products
- Mkinsight reporting
- Parliamentary reporting



**1.8** We do a range of work to help the bodies we audit, in line with our overall strategic goal to improve 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 2014-15 to 2016-17* sets out how our public audit perspective will help Parliament hold government to account. The diagram (left) summarises the range of our work, including financial and VfM audit.

### Key facts

344  
organisations audited

## 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.



### 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.



### Independent

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

**Key facts****£3.2m**income from our work  
with the United Nations**£0.7m**income from helping  
strengthen other  
Supreme Audit  
Institutions and public  
accounts committees

## Impact of our work

**1.10** We use our work to help the organisations we audit to 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 2014-15 we reported a financial impact of £1.15 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, as well as in a separate report on our website: [www.nao.org.uk/report/impacts-from-our-work-2014/](http://www.nao.org.uk/report/impacts-from-our-work-2014/)

**1.11** We monitor the acceptance and implementation of recommendations made by the Committee of Public Accounts after our evidence has been taken during a session. We also monitor HM Treasury minutes documenting the government’s response to the Committee of Public Accounts’ recommendations. We also 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 2014 research findings remain in line with previous years. Respondents thought our financial audit work was appropriately thorough and focused on the areas of greatest risk and three-quarters of respondents concluded that the audits had led to changes in their organisation’s approach to financial management and control.

**1.14** We survey all clients following publication or certification. Client feedback for our financial audit during 2014-15 highlighted that our audited bodies rated us most strongly in respect of our professionalism, our understanding of the organisation and the risks which it faces and in client engagement. A small proportion felt that we should do more to maintain the continuity of staff and reduce financial audit fees and that across our work we should add more value outside of our core financial audit and value-for-money work.

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## Managing reductions in local authority government funding

Our report on local authority funding reiterated that government must understand the implications of funding reductions on the delivery of local services, and whether supporting local authorities to redesign selected services and join up with other local service providers would deliver the improvements and savings needed.

**Impact:** Our work has been instrumental in securing acknowledgement from the Department for Communities and Local Government (DCLG) that its processes for estimating local authority spending requirements and assessing the potential impacts of spending reductions need to be improved. Our report has also been widely used in the sector. For example, Leeds City Council and Birmingham City Council repeatedly drew on our work to inform their ongoing debate with central government over devolution. Other councils such as Wolverhampton City Council and Oldham Council used the report to inform discussion and decision-making in cabinet meetings and audit and scrutiny committees. More widely, commentators including the Local Government Association and treasurers' societies have used our analysis to inform their thinking, and firms such as Grant Thornton and KPMG have included substantial coverage of the work in the audit updates for many local authorities.

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### Key facts

442

accounts certified

65

major outputs, comprising 49 value-for-money studies, 13 investigations and 3 financial reports

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## Increasing the effectiveness of tax collection

In 2015, we published a report examining how HM Revenue & Customs (HMRC) responded to recommendations from the NAO and the Committee of Public Accounts in areas our work has focused on since 2010.

**Impact:** HMRC responded positively to our recommendations and made changes in significant areas of tax administration. We made more than 130 recommendations to HMRC and it has implemented more than 80% of them. Following our report on marketed tax avoidance schemes, HMRC obtained new powers to change the economics of tax avoidance by increasing the risks and reducing the advantages of using or promoting avoidance schemes. It also set up a new counter-avoidance directorate to coordinate its activities better. HMRC estimates that its new measures to tackle anti-avoidance will increase tax revenue by £400 million in 2014-15 and more than £1,600 million in 2015-16. HMRC improved the transparency and accountability around how it settles large tax disputes in response to our recommendations. It appointed a new tax assurance commissioner, who publishes an annual report describing its progress in resolving major disputes. Its new governance arrangements provide more independent challenge with greater separation between those working on a dispute and those responsible for approving how it is resolved.

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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 400 financial statement audits each year. These vary in size from large government departments, such as the Department for Work & Pensions (DWP), 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 auditor of central government bodies. Details of the bodies which we audit are contained on our website: [www.nao.org.uk](http://www.nao.org.uk)

**2.2** The C&AG also gives 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 risk and public concern, helping us to 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 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.

**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 director general, audit quality holds operational responsibility for quality across all of our work.

**2.7** The director general is supported by an integrated 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. The director general is guided by APQ and is advised on matters relating to audit policy and quality by groups of senior audit practitioners.

### Key facts

60

Committee of Public Accounts evidence sessions supported

24

other Parliamentary committees supported

17

departmental overviews published

**Key facts**

43%

of our front-line staff  
are women

## 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 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 Standards on Quality Control for audits (ISQC1). The director general, audit quality is responsible for ensuring compliance with these 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 engagement teams' independence and objectivity could be, or could be 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 rotate senior staff on financial audit, which is beyond what is required by the standards. Detailed procedures for identifying potential threats to independence and establishing appropriate safeguards are embedded into our financial 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 main 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 the largest source of financial management expertise within government. It is important that we make this expertise available to further develop 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 auditors can use secondments to non-clients to enhance their skills within specific sectors. When we consider the case for a 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 draw on three 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. We have discussed this with the FRC. The FRC is revising the UK Ethical Standards following the EU Audit Directive. These will be subject to public consultation. The NAO will respond to this consultation and will consider the NAO's policies once the revised Ethical Standards are issued for use.



## Our people

**2.16** We provide 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 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.

**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. Over the past two years, we recruited expertise in local government, corporate finance, health and IT 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 six days of structured training. This includes training in areas of specialist accounting and central government audit.

**2.19** In addition to the comprehensive training programme, we have a secondment programme to the public and private sector. This is an important programme, which develops staff, increases our knowledge of how government entities work, and also benefits our clients by providing experienced staff.



**Key facts**

779

full-time equivalent  
permanent employees

## High-quality engagement performance

**2.20** Financial audit work follows a standardised format. 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 arrangements for oversight and funding of alternative higher education providers.

## Value for money

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

**2.22** 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 are currently reviewing the standards to reflect the full range of work undertaken by the NAO. Further details on the standards are set out in Appendix Two: Assurance and control.

**2.23** 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 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

**2.24** All our 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 ISQC 1 (UK and Ireland). Meeting these standards means that our financial audit work also complies with the relevant ISSAIs established by the International Organisation for Supreme Audit Institutions (INTOSAI).



**2.25** 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 FRC Audit and Assurance Council, ICAEW, CIPFA, FEE and INTOSAI. These appointments seek to ensure that the public sector perspective is properly reflected in developments within the accounting and auditing profession.

**2.26** Our audit methodology is outlined in our *Financial Audit Manual*, which is updated annually. 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.

**2.27** 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 the work in a number of specific review stages. All work undergoes a two-stage review by the 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 director. Audit Panels comprising senior practitioners are convened to consider all qualifications and significant audit judgements.

**2.28** 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. Hot reviews are completed before an account is certified and cold reviews are completed after. The compliance and quality unit also seeks annual feedback from all audited bodies on the audit's performance.

**2.29** 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 and, where appropriate, incorporate them into further guidance or training, or both.

**2.30** The internal cold review process in 2014-15 identified potential improvements to a number of areas. These were improvements to our documentation to demonstrate the range of consultation and to fully outline the work conducted on key audit judgements. In addition, it highlighted that we should enhance the training provided to individuals undertaking more senior roles within the audit team for the first time. These findings largely accorded with the findings from our external reviewer, the FRC's audit quality review team (AQR).

**Key facts**

6

average number of days  
of structured training  
per person

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

- clarified guidance within our audit manual and augmented our standard audit documentation templates and work programmes to support consistent levels of documentation across all files;
- provided additional training material for engagement managers and engagement directors where they are adopting that role for the first time; and
- moved to team-based training, delivered jointly between team management and the practice and quality team to ensure that training is focused on the areas of greatest relevance and encompasses all staff responsible for the audit.

**2.32** Further details on the review and assurance processes for financial audit can be found in Appendix Two: Assurance and control.

**2.33** Audit quality forms a vital part of our financial audit performance management framework for individuals. Failings in audit quality will adversely affect the performance assessment of directors and their teams.

## External monitoring for high-quality audit

**2.34** The practice and quality team considers and reports the results of the external monitoring and feedback from audit clients to APQ. The director general, audit quality also reports annually on the results of the quality assurance processes to the leadership team and the board on main quality issues.

### External monitoring – value-for-money studies 2014-15

**2.35** Each year external specialists review a sample of published VfM studies. Oxford Business Schools, Risk Solutions and Rand Europe undertake this work. The reviews completed during 2014-15 examined 16 reports. The reviews considered the scope of the study, qualitative analysis, structure and presentation, graphs and statistics, the methods utilised, synthesis of VfM conclusions, recommendations, systematic issues and overall perception.

**2.36** Reviewers generally assessed reports as well-structured, consistent in content and tone and persuasive, with well-presented data. Reviewers did feel that the NAO could make greater use of sector experts. They also identified potential improvements in the clarity of reports and the use of plain English. Further details of these monitoring arrangements can be found in Appendix Two: Assurance and control.

## External monitoring – financial audit 2014-15

**2.37** Each year, the FRC's AQR inspects our work. The AQR is required to inspect the work which we complete under the Companies Act; however, we voluntarily invite them to inspect the work which we complete under statute. In 2014-15, the AQR considered six audits in detail and also undertook a full review of the NAO's office-wide quality processes. This included a review of the NAO's financial audit methodology.

**2.38** The inspection concluded that the NAO had maintained the overall quality of its financial audit work. The inspection highlighted a number of 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

We work to practise what we preach by upholding high standards of governance in our operations and decision-making

- 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 appoints the non-executive members. However, the chair is appointed by the Queen under letters patent, upon the recommendation of 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.
- 5 During 2014-15 our board members were:
  - Lord (Michael) Bichard, Chairman of the National Audit Office (NAO) board from January 2015.
  - Professor Sir Andrew Likierman, Chairman of the NAO board to 9 January 2015.
  - Sir Amyas Morse KCB, C&AG.
  - Michael Whitehouse, Chief Operating Officer and member of the NAO board.
  - Naaz Coker, non-executive member of the NAO board.
  - Gillian Guy, non-executive member and Chair of Audit Committee to December 2014.
  - Joanne Shaw, non-executive member and Chair of Audit Committee from January 2015.
  - Ray Shostak, non-executive member from January 2015.
  - Robert Sykes, non-executive member from January 2015.
  - Paula Hay-Plumb, non-executive member to November 2014.
  - Dame Mary Keegan, non-executive member to December 2014.
  - John Thorpe, Executive Leader and member of the NAO board.
  - Gabrielle Cohen, Executive Leader and member of the NAO board. Gaby Cohen left the NAO in April 2015.
  - Sally Howes (Executive Leader) will serve as an executive member of the NAO board for 2015-16.
  - Sue Higgins (Executive Leader) will serve as an executive member of the NAO board for 2015-16.

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*. 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 meets eight times a year to discharge its responsibilities, which are set out in the Act and complement the C&AG's responsibilities. The board attend two Strategy Days in the year, to focus on the NAO's strategic objectives and progress against strategy. 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 Public Accounts Commission 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 Public Accounts Commission.

**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.

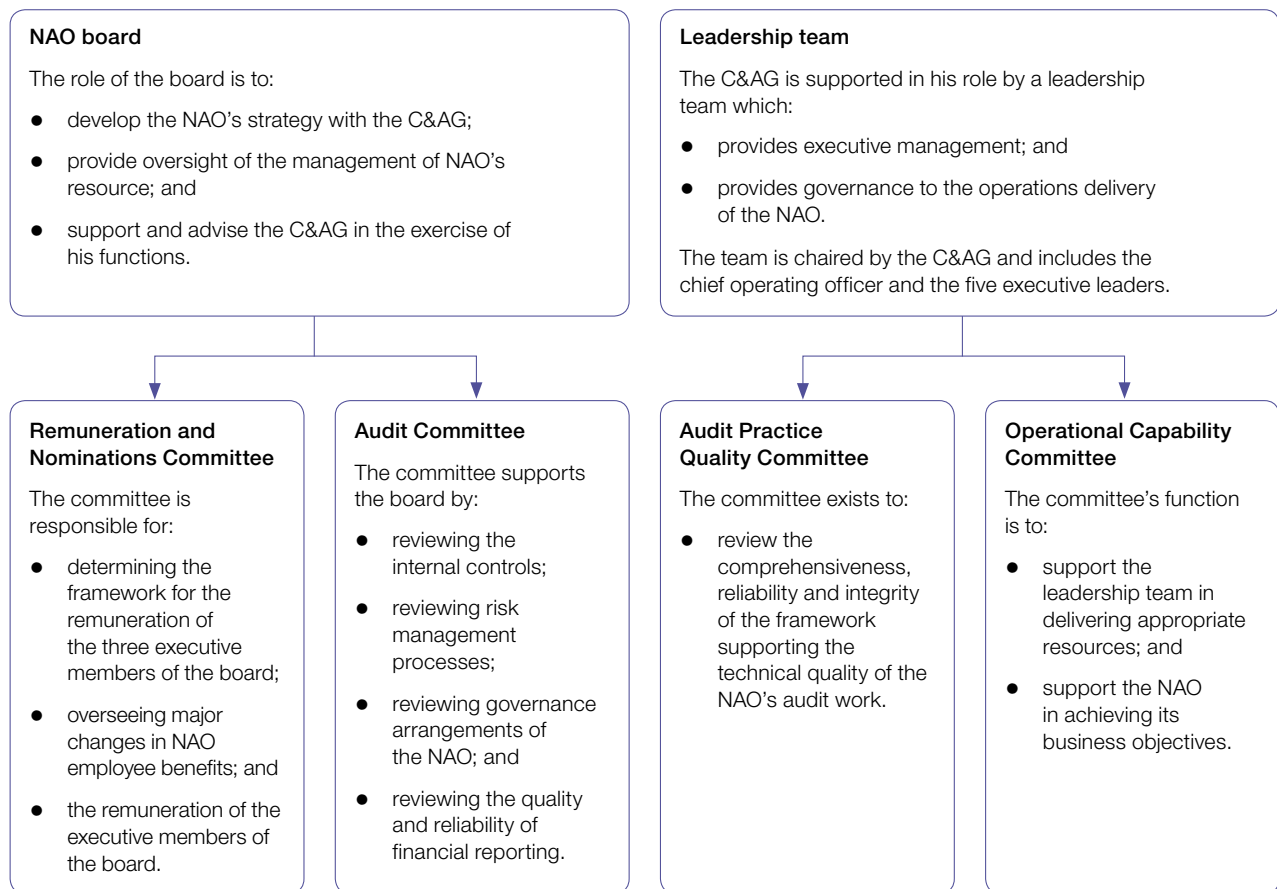
**10** The C&AG is supported in his role by the leadership team. The leadership team helps the C&AG to develop and implement strategy, lead staff, set work priorities, monitor performance and manage risk.

**11** The NAO is accountable to Parliament, via the Public Accounts Commission. The Public Accounts Commission'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 their reports, to appoint non-executive members of the board, and to report from time to time.

12 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.



## Structure

**13** 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:

**14** Insert the cluster descriptions / graphic from the NAO 2014-15 annual report on page 13.

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

**16** 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 who work across the clusters within 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
- help the NAO to provide an authoritative voice in areas of strategic interest.

**17** We have two umbrella communities of practice, which include various specialist disciplines:

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### Communities of practice within the NAO

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

Behavioural insights

Data analytics

Decision analytic modelling

Economics

Financial analysis

Financial audit statistics

Mapping

Qualitative methods

Surveys

Value-for-money statistics

#### **ODCop (Operational Delivery)**

Corporate finance

Commercial and contracting

Digital

Operations and process management

Project and programme delivery

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## People

**18** We employed an average of 779 full-time equivalent permanent staff during 2014-15. Most of our staff are qualified or trainee accountants and more than 60% are members of, or trainees with, the main accountancy institutes. This expertise is supported by other staff with specialisms in areas such as economics, statistics and information technology.

**19** We are a registered trainer for the ICAEW. In addition, we provide professional training for employees taking the ACCA, CIMA and CIPFA qualifications. We recruit and train approximately 75 trainees a year, who undertake structured training towards becoming chartered accountants through ICAEW.

**20** 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.

**21** There is managed progression through the grades. We have two development programmes to identify and support individuals of high potential. The Emerging Leaders programme is aimed at those at an earlier stage in their career. The Direct programme is aimed at managers with the potential to become directors.

**22** Continual staff development is also supported by a programme of staff secondments into government bodies and other organisations. This is valuable in increasing insight into how the government works and helping to cast useful and practical recommendations for our reports. We take care when redeploying staff on return, to avoid conflicts of interests.

**23** We publish an organisation chart showing our structure and seniors managers' responsibilities on our website. In 2014-15, the staff distribution by grade and gender for front-line staff was as follows:

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### Staff distribution

Grade	Percentage	Female	Male
Leadership	1%	40%	60%
Director	6%	25%	75%
Manager	22%	40%	60%
Lead	39%	47%	53%
Trainee/others	32%	42%	58%
Total front-line staff mix	100%	43%	57%

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**24** We give staff suitable training opportunities to ensure continual professional development, and use clear objectives to measure their performance. Pay is directly linked to performance and all staff must seek and give feedback on performance, to manage their own development.

**25** We are independent of government pay policy, although we consider wider public sector pay issues and have performance-related pay with a focus on base pay increases. There is no system of bonuses. In addition to salary, the largest non-pay benefit (aside from professional training) is the Civil Service Pension Scheme.

## Financial information

**26** 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 2014-15, this review looked at the Transformation Programme, which the NAO implemented during 2013-14. The Transformation Programme was responsible for, among other things, our reorganisation into clusters and a shift to a more role-based organisation to more effectively and efficiently support Parliament. The review found strong evidence that the NAO had started to transform, wide support for the principles of the change and that savings made in 2013-14 were higher than the original target. It made recommendations for further action to ensure that the NAO was able to realise the full benefits of the change, in particular on culture, skills and accountability. Management accepted each of these recommendations and has taken action to implement them.

**27** Insert diagram from NAO annual report 2014-15 page 11 on main aspects of transformation

**28** Our full financial information is contained in our Annual Report and Accounts 2014-15, which can be found on our website at: [www.nao.org.uk](http://www.nao.org.uk)

## National Audit Office operating segments

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

**Note**

1 Included in the financial audit operating segment is international audit work with a gross expenditure of £2.9 million and income of £3.3 million.

	2013-14 restated <sup>1</sup>								
	Financial audit £000	Value for money £000	Investigations and insight £000	Support to Parliament £000	International relations £000	Comptroller function £000	Restructuring £000	Non-voted £000	Total £000
Gross expenditure	46,767	17,550	12,997	4,983	2,115	204	4,206	293	<b>89,115</b>
Income from services provided	(16,184)	–	–	(1,284)	(1,178)	–	–	–	<b>(18,646)</b>
Rental income	(920)	(346)	(256)	(98)	(42)	(4)	–	–	<b>(1,666)</b>
<b>Net expenditure</b>	<b>29,663</b>	<b>17,204</b>	<b>12,741</b>	<b>3,601</b>	<b>895</b>	<b>200</b>	<b>4,206</b>	<b>293</b>	<b>68,803</b>

**Note**

1 Restated to report the support to Parliament and to international bodies separately; both were reported under 'Support to Parliament, the public and other organisations' in 2013-14. The non-voted expenditure is also being disclosed separately because it is paid directly from the Consolidated Fund and is not managed by the NAO.

**29** 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/)

# Appendix Two

## Assurance and control

As part of the Transformation Programme, we developed a skills strategy to ensure that we continue to develop the skills to meet the needs of our assurance products

## Financial audit

**1** Many of the Comptroller and Auditor General's (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 2014-15.

**2** Where the C&AG is appointed as auditor other than by statutory appointment, the National Audit Office (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 and the director general of audit 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 competency. 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 general, audit 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) (ISAs) and how we must apply these. The manual is updated annually, 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, makes it straightforward for engagement teams to comply with standards and internal policy. This encourages efficient working by increasing standardisation and reducing the need for teams to recreate standard audit approaches. The audit approach is codified in 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 general, audit quality, before concluding on that matter.

**8** The most significant technical issues will be considered by an audit panel. The panel comprises senior practitioners and may include the C&AG, chief operating officer and executive leaders. It is convened to give the C&AG advice on specific issues as these arise.

**9** Some engagements are assigned an engagement quality control reviewer (EQCR), who is a 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 of high stakeholder interest) 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 each year and over each engagement manager over a period of three years. These 'cold reviews' are more detailed than 'hot reviews'. 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;
- any opportunities to improve documentation and make efficiencies in the audit approach for the following audit cycle; and
- the consistency of message and appearance of client-facing documentation.

## Training and technical competence

### Training

**12** Supporting the professional accountancy training received by all trainee auditors, the director general, audit 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 and changes to our audit methodology; 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 2014-15 targeted training was provided in the following areas:

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

**16** As part of the Transformation Programme, we developed a skills strategy to ensure that we continue to develop the skills to meet the needs of our new assurance products. One of the benefits of operating in a transformed NAO is that we enjoy a far more role-based organisation, where a colleague's grade is second to the role they are awarded based on ability. This approach allows colleagues to gain valuable experience of working in a higher role to support their career development. We have also developed programmes 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 general, audit 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 *Code of Conduct*; and
- are Consultative Committee of Accountancy Bodies-qualified or exam-qualified.

**18** The director general, audit quality gives specialist licences to staff whose work involves 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 handbook*. The handbook 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 handbook is held electronically and updated whenever a change is made to VfM arrangements. It is supplemented by more detailed guidance relating to specific stages in the lifecycle of a VfM study, and by analytical and technical guidance on VfM methods and approaches.

**21** These policies and procedures are underpinned by the NAO's VfM standards, which set out the expectations that all VfM studies 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 ten standards covering:

- quality assurance;
- study selection and engagement;
- study design;
- evidence reliability and documentation;
- objective analysis;
- balanced and persuasive reporting;
- project management and reporting;
- client engagement;
- report delivery; and
- learning and disseminating lessons from conducting VfM studies.



## 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 ten 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. A director and a manager independent of the team conducts 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 2014-15) 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 in the technical areas.

**26** During 2014-15, we began to provide formal one-to-one coaching for people who wished to explore and address underperformance across any aspect of their work.

## External monitoring

### External review – financial audit

**27** The audit quality review team (AQR) of the Financial Reporting Council (FRC) reviews our whole-office procedures and a selection of audit files. In 2014-15, the AQR reviewed six completed audit files (2013-14: 6), of which two (2013-14: 2) were performed under the Companies Act 2006. We responded to their findings.

**28** The AQR also reviewed policies, processes and procedures supporting audit quality. This considered methodology, related training (including training in relation to IT audit) and guidance. In addition, the inspection considered the actions taken on findings arising from the 2013-14 inspection.

**29** The inspection concluded that the NAO had maintained the overall quality of its financial audit work. The inspection highlighted a number of areas for further improvement.

**30** The AQR continued to highlight that our policy on secondments did not comply with ethical standards. We have discussed this with the FRC. The FRC is revising the UK Ethical Standards following the EU Audit Directive. These will be subject to public consultation. The NAO will respond to this consultation and will consider the NAO's policies once the revised Ethical Standards are issued for use.

**31** The AQR highlighted some areas for further improvement. These included ensuring that the sample of journals tested fully reflects the risk of management override and fraud, improving communications to ensure that all significant risks and extrapolated errors are reported to those charged with governance in all cases. The AQR review also noted that our audit documentation could be improved in the robustness of our challenge, the extent and timeliness of EQCR involvement and our consideration of audit risks, particularly surrounding the IT environment.

**32** We have addressed these issues by:

- communicating the AQR's findings to all staff and incorporating the feedback into our annual assurance training;
- updating our standard audit documentation templates and guidance to support the testing of journals and the further integration of our IT audit work (including placing reliance on information provided by the entity);
- launching a training programme to support our staff in auditing complex IT environments;
- providing mandatory training to all EQCR directors to ensure that they adopt a consistent approach in undertaking and documenting their role; and
- re-emphasising the importance of embedding our consideration of risk throughout the audit via office-wide annual technical updates and the publication of a discussion paper on risk-based audit, which audit teams are encouraged to use in planning their audits.

### External review – VfM reports

**33** For 21 years we have used external specialists to review VfM reports. In 2014-15, a sample of our reports were reviewed by independent experts from Oxford University Said Business School, Risk Solutions/Cass Business School and RAND Europe.

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

- scope
- structure and presentation
- administrative and managerial context
- how far systemic issues are identified
- methodology
- adequacy of qualitative analysis
- graphics and statistics
- synthesis of analyses and whether this supports the VfM conclusion
- appropriateness of recommendations.

**35** The external reviewers provide a written review assessing how each report meets professional standards against the criteria and an overall assessment. Since September 2010 they have done this to a sample of reports, and 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.

**36** Our central practice and quality team also seeks formal feedback from clients on individual studies on a range of areas. These include the conduct of the study and whether the conclusion was well founded, our staff's professionalism, engagement with the client and the knowledge of the team. Our surveys are conducted electronically and are sent to the appropriate senior contacts for each report at the audited body. This gives us better and timely feedback.



National Audit Office

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