



National Audit Office

National Audit Office

Transparency report 2013

DECEMBER 2013

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), Amyas Morse, is an Officer of the House of Commons and leads the NAO, which employs some 860 staff. 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 almost £1.2 billion in 2012.

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Introduction

This Transparency report has been prepared in accordance with 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 the National Audit Office (NAO) for the last three years the NAO has chosen to produce its own transparency report to comply with best practice. The board endorsed this report on 24 October 2013.

Foreword

from the Comptroller and Auditor General



Supported by the National Audit Office (NAO), as Comptroller and Auditor General (C&AG), my role is to give Parliament assurance about how public money is spent. The public sector is going through substantial change and money is tight. We have a critical role to play in adding value to the government, by supporting its work to improve public services.

Our staff skills, insight and expertise are central to our work to add value. We use critical thinking, insight and a deep understanding of the most important strategic issues and risks faced by government and the bodies we audit. We also provide technical rigour, objectivity and independence. Our reports hold up a mirror to public sector managers to improve public services. We have a strong reputation, but the expectations for us are growing. Parliament and departments are more demanding of us. So we have embarked on a transformation programme to build on our success and ensure that we are always achieving our best. We will do this by providing more expert, integrated assurance; by providing a wider range of interventions; and by deepening our expertise to align with the strategic issues that the government faces.

This report explains how we ensure that our audit work meets the highest professional standards expected of us – as the statutory auditor of central government with extensive reporting rights to Parliament.

Transparency is vital to maintaining quality and stakeholder confidence. I am pleased to report back to our stakeholders on how we are discharging our responsibilities on audit quality.

I welcome any comments you have on any aspect of this report.

Amyas C E Morse
Comptroller and Auditor General

Part One

About the NAO



“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 impacts we achieve. It also sets out how we will transform the NAO to achieve even greater impact”

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 CEO and Accounting Officer of the 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.

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 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, both their income and expenditure, and report on them to Parliament. This is our 'financial audit' work. In 2012-13, we audited expenditure and revenue amounting to over £1 trillion across 437 accounts for 355 organisations.

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 2012-13, we published 60 VFM reports on key government initiatives and the current challenges government faces. We also published an additional three reports on local services. 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.

1.8 We do a range of other work to help the bodies we audit; identifying barriers to good performance and deepening our insight and understanding of the issues that they face. The diagram overleaf summarises the five dimensions of our work, in addition to financial and VFM audit.

There are five dimensions to our work

Financial audit

We certified 437 accounts in 355 organisations in 2012-13.

Bodies we audit include government departments, charities and some companies.

Value for money studies

We published 60 value for money reports and 3 studies focused on local services in 2012-13.

We highlight important lessons for the bodies we audit and for government more widely.

Performance improvement

This work enables us to respond quickly to important issues that public bodies currently face.

Our work focuses on robust financial management, using information better and areas where MPs and others have concerns.

Support to Parliament

We help the Committee of Public Accounts (PAC), other select committees, and individual MPs in their scrutiny of public spending and service delivery.

The PAC held 57 hearings based on our work in 2012-13.

International

We are on the UN Board of Auditors, and audit a range of other international organisations.

We report on EU spending in the UK.

We are a member of the INTOSAI board.

1.9 Professional standards and guidelines are essential for the credibility, quality and professionalism of public-sector auditing. In our audit work we apply the highest levels of ethical and professional standards, and we have adopted the relevant ethical and professional standards applicable to auditing bodies. We conduct our financial audit work in accordance with the International Standards on Auditing (ISAs) (UK and Ireland) (which require us to comply with the Ethical Standards for Auditors published by the Financial Reporting Council) and our VFM work in accordance with our VFM standards. Both of these are consistent with the Fundamental Auditing Principles of the International Standards of Supreme Audit Institutions (ISSAIs) developed by the International Organisation of Supreme Audit Institutions (INTOSAI). These principles are designed to promote independent and effective auditing by supreme audit institutions (SAIs). We also comply with the requirements of the International Standard on Quality Control (ISQC (UK & Ire) 1). This standard requires bodies providing audit services to establish, document and monitor systems of quality control and to communicate these systems to their personnel. The requirements of this standard are applied across all of our work. Detailed information on our audit approach and underpinning quality assurance arrangements is contained in Part Two of this report and in Appendix Two.

Our values

1.10 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.



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.

Impact of our work

1.11 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 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.

1.12 In 2012, we reported a financial impact of almost £1.2 billion savings to government departments. We surveyed 90 of our audit clients asking them to rate the quality and value our audit work added to their organisations. Respondents gave an average score of 3.23 out of a possible 4, for the insight we gave them through our recommendations.

1.13 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 include examples such as:

We helped the Ministry of Defence reduce excess stock

We found that the Ministry of Defence was keeping its inventory levels at an unnecessarily high level, tying up resources. The Permanent Secretary and the Chief of Defence Materiel reported that the Department had changed its inventory policy because of our report, using our analysis to plan new stock levels. We estimate that the Department made £253 million of savings on inventory purchases in 2011-12 because of our recommendations.

Promoting growth through apprenticeships

Our 2012 report on the adult apprenticeships programme found that the programme could benefit the economy by £18 for every £1 spent. However, the Department for Business, Innovation & Skills could get better value for money by targeting its spending on sectors that produce the most economic benefit. In response to our report, and subsequent Committee of Public Accounts recommendations:

- the Department commissioned research on which areas give the greatest economic returns;
 - the Skills Funding Agency reviewed whether, and where, providers were making excess profits; and
 - the National Apprenticeship Service revised its rules from August 2012, so that apprenticeships would normally be expected to last between one to four years.
-

Investigating concerns about the Department for Work & Pensions' medical services contract

Following correspondence received from members of parliament and members of the public, we reviewed how the Department has managed its medical services contract with Atos Healthcare. As a result, we recommended ways in which the Department could strengthen its oversight of the contract. The Department agreed with a number of the recommendations, and it has made, or is considering, a number of changes to improve its oversight of contractor performance.

1.14 However, we recognise that we need to further develop our measure of impact and influence. Our quality assurance showed that in 2012 fewer of our clients thought that our VFM work has led to tangible efficiency gains than in the previous year. In 2013-14, as part of our transformation programme we are working to deepen our insight into the issues faced by the bodies we audit. We will ensure that our work is focused on the areas of greatest relevance to them and Parliament.

Transforming the NAO

1.15 Our audit work over the past four years has had significant impact at lower cost. Feedback from Parliament and departments is that they would like us to do more to strengthen accountability and to help improve public services. In particular, departments want more comparative work. And Parliament wants us to investigate promptly where they, or the public, alert us to potential problems in public services.

1.16 In 2013-14, our transformation programme will help to deepen our understanding of the challenges the government faces, and build our expertise in these issues. We have grouped our teams into six clusters, each focused on a key strategic issue shared by some of the bodies we audit. Each is working to determine the skills required to develop expertise in its strategic issue. The clusters will become centres of sector expertise with strong core audit skills, and will develop and apply that insight to the issue.

1.17 We will use this deeper insight to provide more value and more integrated work for the bodies we audit. We will also develop a wider range of audit work, including investigations, reports and memoranda to inform Parliamentary scrutiny. We will continue to expand our capability to conduct investigative work. This is where Parliament and the public raise concerns, or where we review projects and programmes early on, so that we can help maximise the potential for achieving value for money. This will allow us to give lasting value through all our work, and support Parliament in holding departments to account.

Part Two

Audit independence and quality

“The quality of our work is central to our ability to help improve public services. Our stakeholders in Parliament and government departments have high expectations of us. Maintaining high quality in our work is crucial to ensure that we provide credible and authoritative commentary on how public bodies use funds.

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

Jeremy Lonsdale and Maggie McGhee

Introduction

2.1 The C&AG, supported by the NAO, undertakes around 440 financial statement audits 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 non-departmental public bodies. This means that he is the sole auditor of central government bodies.

2.2 In addition, the C&AG 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 Throughout 2013, we have looked at ways in which we can increase our contribution to improving public services, and have broadened our product range accordingly. In addition to providing assurance to Parliament through our value for money and financial audit work streams, we have also identified a wider range of assurance products to help us secure influence. The same principles of independence, quality and integrity apply to all our products.

Quality control

“Quality is embedded in all our work. It is secured through our systems and processes but, just as importantly, through our culture and ethos, and the tone set by the leadership team.”

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 audit practice and quality committee (APQ) oversees our policy on the technical quality of our work. It makes sure that our methodologies and audit approaches are fit for purpose and comply with good practice, and it scrutinises quality assurance arrangements.

2.6 During 2012-13, the Director General VFM and the Director General Financial Audit were responsible for quality. Both report formally to the C&AG on significant issues affecting the quality of our work. The directors general are guided by the APQ and are advised on matters relating to audit policy and quality by groups of senior audit practitioners. Directors in both disciplines met monthly to discuss operational and technical issues.

2.7 The framework supporting quality assurance changed in autumn 2013. The C&AG, with the leadership team, will continue to be responsible for quality and a single Director General, Quality Assurance will have operational responsibility for quality across all of our work. The Director General will be supported by an integrated compliance and quality unit, and quality leads within each cluster.

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, as stated in paragraph 1.10.

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 and international standards on quality control for audits (ISQC1 (UK & Ire)). The directors general are responsible for ensuring compliance with these and for creating a culture of professionalism, rigour and openness to challenge. This responsibility transferred to the Director General, Quality Assurance in autumn 2013.

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 to which we must adhere. All staff provide an annual declaration 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 secure revenue-generating business 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. Income is received for international cooperation work, and this work does cause a conflict with our audited bodies. 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 the financial audit methodology.

2.12 The ethical standards are primarily designed to address issues of auditor independence. We do not consider that these standards fully address the circumstances of a statutory public sector auditor. There are therefore a small number of areas where we do not comply with the ethical standards. The key area being in relation to secondments. The ethical standard prohibits secondments to management positions in an audit body.

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. As the statutory appointed auditor for the entire central government sector, the requirements of the standards would prohibit the NAO from seconding staff into a management position of any body within the sector and would limit our ability to increase our corporate knowledge. This would not be replicated in the commercial sector as firms will have the opportunity to second staff to organisations within a sector that they audit for which they are not the appointed auditor. When the NAO considers 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 The Audit Quality Review team has highlighted that our secondments policy does not comply with the requirements of the ethical standards and as a result of this challenge we are seeking to explain why we think a change to the standard would be appropriate for public sector audits. We have not yet formally requested any change.

Our people

“The NAO is a highly-skilled organisation with 73 per cent of staff having a professional qualification, specific functional or technical skill.”

2.15 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 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 technical disciplines, including economics, statistics, social sciences and operational research. Our trainee accountants and specialist staff follow clearly defined development paths to gain the necessary experience.

2.16 We have recruited individuals with additional specific skills over the last three years – especially local service provision, economics and ICT – to help us better understand specific risks in our audits.

2.17 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 can elect to undertake further training on specific areas. This includes training in areas of specialist accounting and central government audit.

2.18 In addition to a 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.

2.19 As part of the transformation programme we are developing a new skills strategy. This will help us to develop the skills to create our wider range of assurance products, and meet the different expectations on roles and responsibilities associated with the changes to how we work.

High-quality engagement performance

“Our audit work must be rigorous, supported by appropriate and relevant evidence, to meet the highest standards of professionalism recognised within the audit community and among expert practitioners in other disciplines.”

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, to landscape reviews of particular policy areas, and briefings on specific issues. It also includes investigations of specific problems, such as our work on gagging clauses.

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 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 have reviewed and will update the standards in 2013-14 to include the recent developments in our product range. Further details on the standards are set out in Appendix Two.

2.23 VFM studies are subject to a multi-stage quality assurance process involving both internal and external review (see Appendix Two for further information). Our internal cold review process checks adherence with the VFM standards and identifies and disseminates lessons to improve our VFM work.

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 International Standards on Quality Control 1 (ISQC (UK & Ire) 1). Meeting these standards means that our financial audit work also complies with the relevant International Standards for Supreme Audit Institutions (SSAIs) 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 best practice.

2.26 Our audit methodology is outlined in the Financial Audit Manual. This includes the requirements of the ISAs and provides guidance on interpreting and implementing those standards within the central government sector. Further details on our financial audit methodology is included in Appendix Two.

2.27 Our audit methodology has been refreshed and the updated methodology will apply to the audits of 2013-14 accounts. The changes are to ensure that the NAO approach is fully focused on key areas of risk and provides even greater insight to the bodies we audit.

2.28 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 and there are 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.

2.29 In addition, we complete an annual quality assurance programme to make sure that we comply with the financial audit manual and ISQC (UK & Ire) 1. Our compliance and quality unit, which reports to the chief operating officer, coordinates a programme of reviews that are completed both before and after an account is certified.

2.30 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.

2.31 The internal cold review process in 2012-13 identified potential improvements to the audit and documentation of pension scheme disclosures and we took targeted action to implement these improvements. In addition, we made some changes to the standard audit documentation tools to further improve audit documentation. Further details on the review and assurance processes for financial audit can be found in Appendix Two.

2.32 Audit quality forms a key 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

“The high technical quality of our work lies in its rigour, logic and clarity.”

2.33 In addition to our quality review, we obtain independent assurance on the technical quality of all our audit work. This independent quality assurance also provides opportunity for learning, development and improvement.

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 also reports 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, 2012-13

“We focus on the right topics and have strengthened the technical quality of our work.”

2.35 Each year external specialists review a sample of 20 published VFM studies. During 2012-13, we re-tendered our external contract and appointed Oxford University’s Saïd Business School (trading as ISIS Innovation), RAND Europe and Risk Solutions to comment on the technical quality of our work. They review our published reports against a set of technical criteria to determine whether we are achieving a ‘professional’ standard. Further details of these monitoring arrangements can be found in Appendix Two. We are in discussions with the organisations to agree an approach to reviews that is appropriate to a wider range of products.

2.36 Our analysis of our performance in 2012-13 shows that we are mostly focusing on the right topics and our work is seen as having a clear purpose and relevance. Our independent reviewers have also suggested that we have strengthened several of the technical aspects of our audits. This message is also strengthened by the agreement from our clients that our conclusions are well founded and our recommendations are based on appropriate evidence. Our reviewers also highlighted areas of weakness.

External monitoring – financial audit, 2012-13

2.37 Each year, the Financial Reporting Council’s audit quality review team (AQR) inspects our work.

2.38 In 2012-13, the AQR reviewed six of our audits, and we responded to findings. The AQR also reviewed the office-wide procedures to support quality. The review considered internal communications, independence and ethics, performance evaluation, training, and audit quality monitoring. The AQR concluded that overall audit quality has improved. However, they continued to highlight that our policy on secondments did not comply with ethical standards. We are discussing with the Financial Reporting Council to determine whether these standards can be applied to a statutory public sector audit body.

2.39 The detailed findings from the AQR review of audit files highlighted areas that required further action. These related to demonstrating appropriate levels of professional scepticism and enhanced documentation for significant events in audit files. We communicated the AQR's findings to all staff and updated the standard audit documentation so that the issues are addressed consistently across all audits

2.40 The AQR review of office-wide procedures resulted in recommendations to enhance our performance appraisal process, including linking attendance at training events to the annual performance appraisal. All recommendations were accepted and we have acted to address the points raised.

Appendix One

Governance and structure

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 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 Comptroller and Auditor General'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 has the confidence of the government and the opposition in Parliament. The C&AG has sole preserve of exercising audit judgements and reaching 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, to be nominated by the C&AG and appointed by the non-executive members.

5 During 2012-13, our board members were:

- Sir Andrew Likierman (Chairman);
- Amyas Morse (C&AG);
- Gabrielle Cohen (Assistant Auditor General, Stakeholder Relationships);
- Naaz Coker (Non-executive Member from 1 July 2012);
- Ruth Evans (Non-executive Member, Chair of Remuneration Committee) (term of office ended on 30 June 2012);
- Richard Fleck (Senior Independent Member) (term of office ended on 30 June 2012);
- Paula Hay-Plumb (Non-executive Member);
- Ed Humpherson (Assistant Auditor General, Economic Affairs);
- Gillian Guy (Non-executive Member from 1 July 2012);
- Dame Mary Keegan (Non-executive Member, Chair of Audit Committee); and
- Michael Whitehouse (Chief Operating Officer).

6 On 1 July 2012, the terms of office of Ruth Evans and Richard Fleck came to an end and they were replaced as non-executive members of the board. Naaz Coker and Gillian Guy replaced them; appointed by the Public Accounts Commission for a term of three years.

7 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.

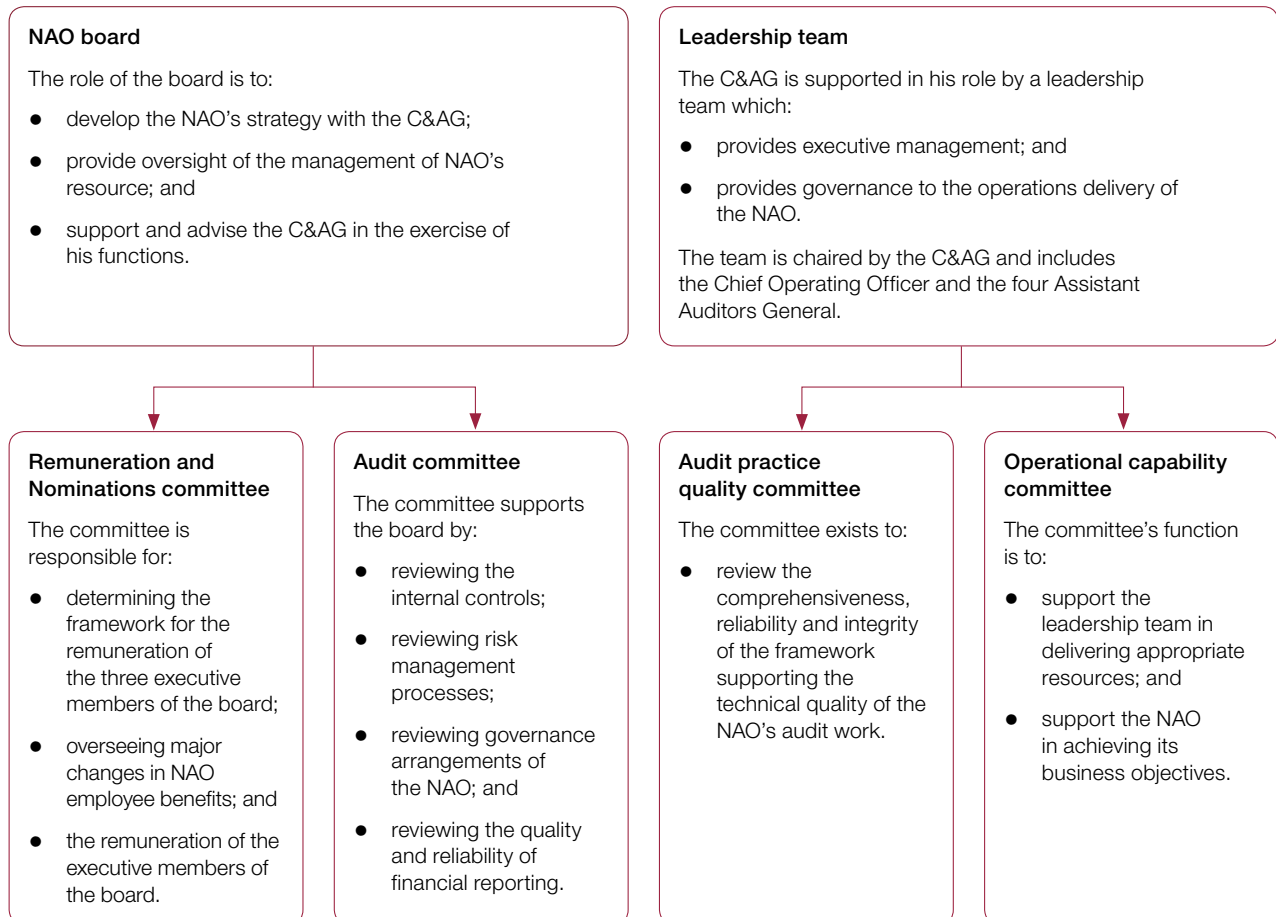
Remuneration and nominations committee

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.

- 8** There is a clear division of responsibility between the Chairman and the C&AG. The Chairman is responsible for leading, and the 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.
- 9** 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 support improvement.
- 10** 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, with the C&AG, prepares the NAO strategy, an estimate of resources required for each financial year, and an annual report on our activities. The board must also recommend the external auditor for appointment by the Public Accounts Commission.
- 11** 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 resources required annually.
- 12** The C&AG is supported in his role by the leadership team. The leadership team helps the Comptroller and Auditor General to develop and implement strategy, lead staff, set work priorities, monitor performance and manage risk.
- 13** 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 the House, 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.
- 14** 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.



The NAO board



Sir Andrew Likierman

Chairman of the NAO

Andrew Likierman is Chairman of the NAO board. He is also Dean of the London Business School. In the course of his career, Andrew has been Head of the Government Accountancy Service and was a Managing Director of the Financial Management, Reporting and Audit Directorate at HM Treasury.



Amyas Morse

Comptroller and Auditor General and member of the NAO board

Amyas Morse was appointed Comptroller and Auditor General 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 also 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.



Michael Whitehouse

Chief Operating Officer and member of the NAO board

Michael Whitehouse was appointed Chief Operating Officer in July 2009. Michael is CIPFA qualified and has extensive experience of value-for-money work across government. 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.



Gabrielle Cohen

Assistant Auditor General and member of the NAO board

Gabrielle Cohen has been an Assistant Auditor General since 2005 and is CIPFA qualified. She was appointed to the board in July 2009. Gabrielle is responsible for leading our stakeholder relations, governance, corporate policy, and relations with Parliament.



Naaz Coker

Non-executive Member of the NAO board

Naaz Coker joined the NAO board in July 2012. She started her career in the National Health Service working as a pharmaceutical officer before becoming a clinical director and general manager. She served as a director at the King's Fund and was Chair of the British Refugee Council for eight years. She served as Chair of the St George's NHS Trust until 2011 and was named Asian Woman of the Year in 2000 and 2003.



Gillian Guy

Non-executive Member of the NAO board

Gillian Guy joined the NAO board in July 2012. She is the Chief Executive of Citizens' Advice and has experience in both the public and voluntary sectors. She began her career as a lawyer in private practice before moving to local government. She served as Chief Executive of the London Borough of Ealing for 12 years and was Chief Executive of Victim Support between 2006 and 2010.



Paula Hay-Plumb

Non-executive Member of the NAO board

Paula Hay-Plumb is an experienced board director in both the public and private sectors, and is currently a Non-executive Director of Hyde Housing Association. She is a Chartered Accountant and a Member of the Association of Corporate Treasurers. Paula is our Senior Independent Director and Chair of the Remuneration Committee.



Ed Humpherson

Assistant Auditor General and Member of the NAO board

Ed Humpherson has been an Assistant Auditor General since 2007. He was appointed to the NAO board in July 2009. He is responsible for the NAO's work on business and economic affairs, including the audits of many key government departments, and the NAO's work on private finance, the third sector, and the government's response to the financial crisis. Ed is Chair of the Audit Practice and Quality Committee.



Dame Mary Keegan

Non-executive Member of the NAO Board

Mary Keegan was Head of the Government Finance Profession and Finance Director at HM Treasury until March 2008. She has also been Chair of the UK Accounting Standards Board, and was the first female partner in the UK audit practice of PricewaterhouseCoopers. Mary is Chair of the Audit Committee.

Structure

15 Our strategy is to use the insights we derive as the government's external auditors to help improve public services. In January 2013, we began a programme to transform how we work, so our strategy can achieve greater impact. By working in clusters, we can compare how government departments address similar issues to highlight how to make improvements.

16 Each cluster is focused on a common strategic issue. By organising ourselves in this way, we will become more effective at sharing our knowledge and developing deep expertise in these strategic issues, to benefit the government and Parliament. The six clusters are:

- Mass market operations
- Influencing and regulating
- Local delivery through networks
- Local service delivery and user experience
- Effective strategic centre
- Delivering major long-term projects

17 By building our investigative capacity, we can better examine the more devolved services and test accountability frameworks. Finally, by being more integrated and building deeper skills, we will achieve further efficiencies.

People

18 We employed an average of 867 full-time equivalent staff during 2012-13. Most of our staff are qualified or trainee accountants and over 60 per cent 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 up to 70 trainees a year, who undertake structured training towards becoming chartered accountants through the Association of Accounting Technicians (AAT).

20 In 2012-13, our trainees again achieved a high level of success at the ICAEW examinations with pass rates continuing to exceed the national average. During 2012-13, two of our trainees, Daniel Morris and Rachel Sheehy, won prizes for the quality of their work in the Financial Accounting examination. Both joined us through the AAT.

21 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.

22 Continual staff development is also supported by a programme of staff secondments into government bodies and other organisations. Secondments can provide different experience for staff; for example, of the pressures of providing services or different approaches to performance assessment. 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 There is managed progression through the grades. We have two development programmes to identify and support individuals of high potential. The future 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.

24 We publish an organisation chart showing our structure and seniors managers' responsibilities on our **website**. In 2012-13, the staff distribution by grade was as follows:

Grade	Percentage
Leadership	<1
Director	8
Manager	19
Lead	39

25 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.

26 We constantly review whether our cohort of staff has the right mix of skills and experience to meet the challenges that financial audit will bring. For example, closing the Audit Commission will mean a wider role for us in local public sector financial audit. Since 2011, we have employed an executive leader who has extensive experience in local government finance,. We have also recently recruited a Financial Audit Director with many years' local government and audit experience to lead a portfolio of probation trust audits, which the C&AG has taken over from the Audit Commission.

27 We are independent of government pay policy, though 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.

28 All staff sign up to our code of conduct annually. The code emphasises the importance of our independence and ensures that we maintain the highest standards of integrity and probity in all our work.

Financial information

29 We are conscious of the need to practise what we preach on financial management. The Public Accounts Commission recently asked our external auditor to assess our financial management against our own model of financial management maturity. The auditor concluded that our financial management processes are sound and that the board and leadership team have a high level of engagement and ownership, along with good levels of engagement by other managers and staff. In addition, the review found that we manage and report our finances in a way that is consistent with the standards we promote.

30 Our full financial information is contained in our *Annual Report and Resource Accounts 2013*, which can be found [here](#). In summary

National Audit Office operating segments

	2012-13					Total
	Financial audit	Value for money	Performance improvement	Support to Parliament, the public and other organisations	Comptroller function	
	£000	£000	£000	£000	£000	£000
Gross expenditure	50,866	19,754	8,662	9,760	199	89,241
Income from services provided	(18,227)	–	–	(2,012)	–	(20,239)
Rental income	(785)	(250)	(108)	(125)	(2)	(1,270)
Net expenditure	31,854	19,504	8,554	7,623	197	67,732

The NAO reports expenditure and income under five areas of work.

Gross expenditure includes staff and other direct costs incurred, plus apportioned overhead costs.

Income from services provided reported under Financial Audit consists of fees for UK and international audits. Income reported under Support to Parliament, the Public and other organisations is generated from secondments and International Technical Cooperation work.

Rental income is apportioned between strategic objectives on the same basis as the overhead apportionment.

	2011-12					Total
	Financial audit	Value for money	Performance improvement	Support to Parliament, the public and other organisations	Comptroller function	
	£000	£000	£000	£000	£000	£000
Gross expenditure	51,316	19,667	7,708	9,036	158	87,885
Income from services provided	(17,452)	–	–	(1,703)	–	(19,155)
Rental income	(413)	(158)	(62)	(73)	(1)	(707)
Net expenditure	33,451	19,509	7,646	7,260	157	68,023

31 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 received**.

Appendix Two

Assurance and control

Financial audit

1 Many 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 2012-13.

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 and the Director General Financial Audit in engagement acceptance matters.

3 For all of the audits proposed we consider, on appointment and in each successive year, if there are issues that might increase or decrease the risk of undertaking an audit. 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 Financial Audit 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 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 fully 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 standard work programmes and any customised work programmes require 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 all 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.

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 Financial Audit, before concluding on that matter.

8 The most significant technical issues will be considered by the audit panel. The panel consists of 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. EQCRs were appointed for 28 financial audits in 2012-13.

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 International Standards on Auditing (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 each financial audit director every 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 Financial Audit 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. As part of their annual Continuing 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.

14 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 2012-13, targeted training was provided in the following areas:

- ethics (including the use of professional scepticism);
- the audit of regularity and propriety;
- parliamentary supply and resource accounting; and
- auditing pension scheme disclosures.

As part of the transformation programme we are revisiting our skills strategy to ensure that we continue to develop the skills to meet the needs of our new assurance products and the different expectations on roles and responsibilities associated with the transformation programme. This will include a new training package for new staff, to support their engagement in all areas of our assurance work.

Audit licences

15 Individuals supervising, managing or directing a financial audit will usually hold the relevant audit licence. The Director General Financial Audit 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 CCAB-qualified or exam-qualified.

16 The Director General Financial Audit grants specialist audit licences to staff whose work involves the audit of companies, pension schemes, charities and accounts prepared under International Public Sector Accounting Standards. This is provided that they have a general audit licence, have an appropriate level of recent experience in the specialist area and have attended any relevant technical updates.

17 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.

18 The Director General Financial Audit performs an annual review of the quality of CPD on a sample of financial auditors who hold audit licences. In 2012-13, 20 individuals were sampled. In all cases the individuals had undertaken training and other learning interventions that were appropriate to their roles.

Value for money

19 Core policies and procedures for 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 now 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 life cycle of a VFM study, and by analytical and technical guidance on VFM methods and approaches. As part of our transformation programme we are considering how best to provide staff with guidance on our wider range of assurance work.

20 These policies and procedures are underpinned by the NAO's VFM standards, which set out the expectations that all VFM studies must meet. VFM staff 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

21 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 former acts as a constructive critic and the latter provides technical and practical advice and guidance respectively throughout the study. The quality of our VFM work is controlled using the following 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. The chief operating officer scrutinises and approves the budget and timetable for studies approved by the C&AG, after the partner director and case manager review the study plan.
- Methods meeting. Managers with technical methodological backgrounds advise on the potential methods for the study team to use.
- Proof-of-concept meeting. The C&AG challenges the study team on how the evidence collected supports the logic of the intended report.
- Draft review. The partner director and case manager, and sometimes other experienced colleagues, review and challenge the draft provisional audit findings.
- 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 and graphics specialists review the graphics data before publication. This is designed to confirm adherence to our standards and readability.
- 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 learned, which they disseminate across the organisation.

- Internal cold review. A sample of 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 20 published reports a year are subject to an independent, external review. The reviewer considers the report against a set of agreed criteria.

Training and technical competence

22 VFM staff are qualified accountants (or training in accountancy) or specialists qualified in other disciplines, such as economics, statistics, social sciences 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 researchers to technical courses for experienced practitioners. Courses for trainees include an introduction to assurance methods (incorporating both financial audit and VFM methodology), interview techniques, and statistics and research methods. Trainees also gain experience of VFM audit by working on studies alongside the financial audit training. We fund more complex technical courses run by external training providers and specialists in the technical areas.

23 We are revisiting our skills strategy to ensure that we continue to develop all skills required to complete our transition to risk-based auditing, to meet the needs of our new range of assurance products, and the different expectations on roles and responsibilities associated with the transformation programme.

External monitoring

External review – financial audit

24 The audit quality review team (AQR) of the Financial Reporting Council reviews our whole-office procedures and a selection of audit files. In 2012-13, the AQR reviewed six completed audit files (2011-12: six), of which two (2011-12: two) were performed under the Companies Act 2006.

25 In addition, the compliance and quality unit seeks annual feedback from all audited bodies on the audit's performance.

External review – VFM reports

26 For nearly 20 years we have used external specialists to reviewed VFM reports. In the first half of 2012-13 independent experts from Oxford University Saïd Business School (trading as ISIS Innovation); and Risk Solutions/Cass Business School reviewed our published reports. In 2013, we ran a competition for new quality assurance partners. We retained ISIS and Risk Solutions as our partners and additionally awarded a contract to RAND Europe.

27 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

28 They provide a written review assessing how each report meets professional standards against each 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 and quality committee (APQ) uses these reviews as the basis of discussions on quality. We are currently discussing with all our partners to agree an approach to review that is appropriate to our wider range of products.

29 Our central practice and quality team also seeks formal feedback from clients on individual studies on a range of issues. Issues include the conduct of the study and whether the conclusion was well founded, our staff's professionalism, engagement with the client, and knowledge of the team. In 2013, we introduced a new electronic survey, which is sent out automatically to the lead policy official at the department audited when our report is published. This gives us better and more timely feedback.



National Audit Office