



National Audit Office

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**National Audit Office**

# Transparency report 2014

**DECEMBER 2014**

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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 820 employees. 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 £1.1 billion in 2013.

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This report can be found on the  
National Audit Office website at  
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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, for the last 5 years we have chosen to produce our own transparency report to comply with best practice. The board endorsed this report on 23 October 2014.

# Foreword

## from the Comptroller and Auditor General



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

In setting out our strategy to Parliament, in the form of the Public Accounts Commission, and gaining approval for our budget for 2013-14 we set out our intentions to transform ourselves to give our work greater focus on the strategic issues facing government, develop our skills and expertise to provide deeper insights into the way government works and provide Parliament with a wider range of products. At the same time we are reducing our costs, increasing our influence and maintaining the quality of our outputs.

Our Annual Report for 2013-14 set out the considerable progress we have made against this strategy. This report complements the Annual Report by focusing 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. 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**

# 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 10 years. He 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. His inspection rights extend to the records of many contractors to central government and those who receive public money.

**1.2** The C&AG is independent from government. To preserve his independence, he has complete discretion in carrying out his functions, responsibility for all audit opinions and judgements rests with him alone.

**1.3** The C&AG is also the CEO and Accounting Officer of the NAO. He is accountable to Parliament for operating the NAO and how we use public money. In carrying out his statutory duties, he is supported by an executive leadership team and statutory board. These 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.

**1.4** Our staff are also totally independent of the government. We are not civil servants and do not report to a minister. We must remain free to report objectively if we are to be effective. We do not advise on policy or specific decisions that the government takes.

## **Our role**

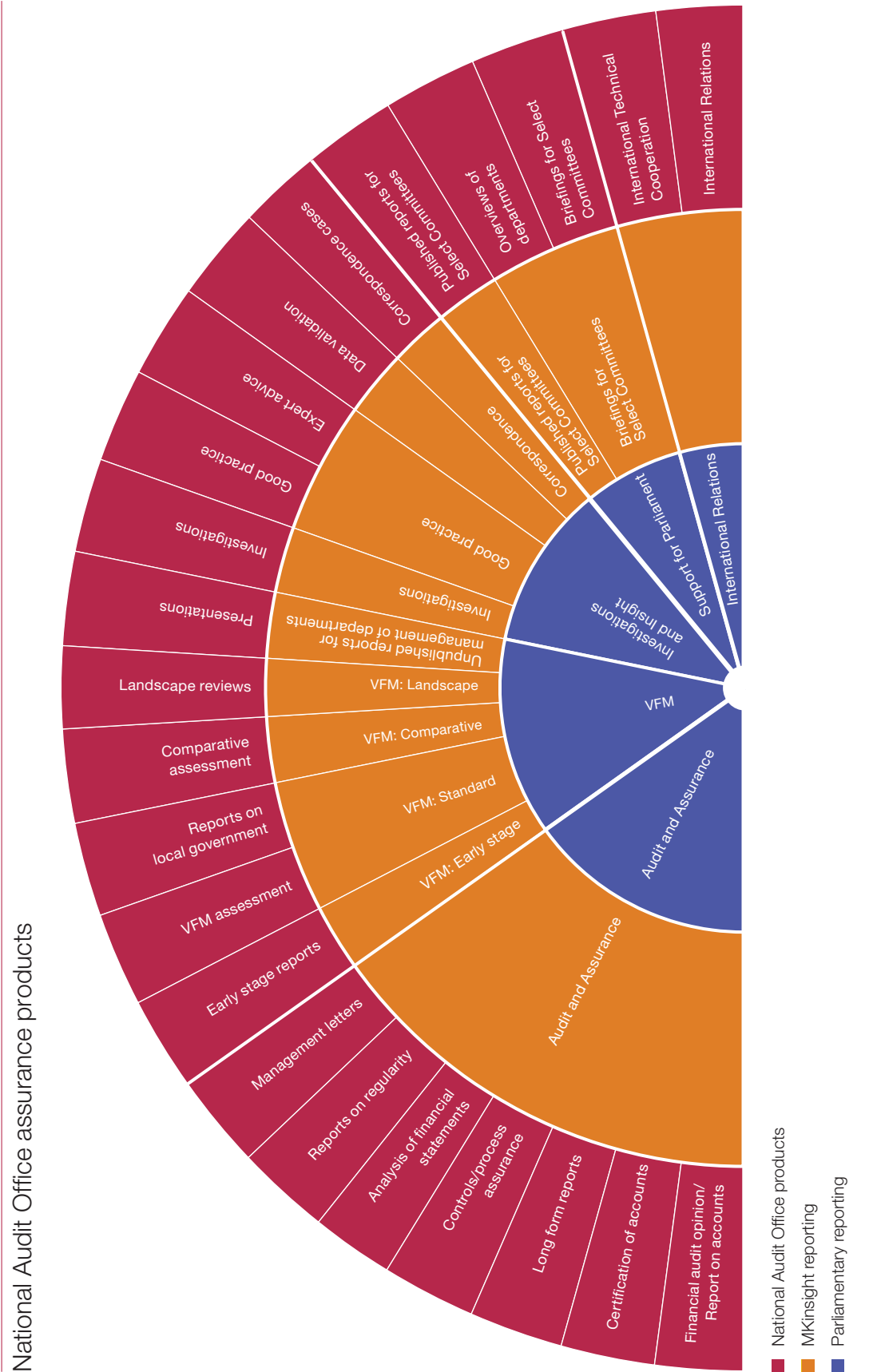
**1.5** We scrutinise public spending for Parliament. We are a body corporate established under the Budget Responsibility and National Audit Act 2011.

**1.6** Our audit of central government has 2 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.

**1.7** We audit the financial statements of nearly all central government organisations, and report on them to Parliament. The financial statements cover both income and expenditure. In 2013-14, we certified 427 accounts with expenditure and revenue amounting to over £1 trillion. This is our 'financial audit' work.

**1.8** We also examine particular areas of central government expenditure and report the outcome to Parliament. This is to establish whether public funds have been used economically, efficiently and effectively. This is our 'value for money (VFM) audit'. In 2013-14, we published 66 VFM reports on key government initiatives and the challenges government faces. We developed our investigative capacity and capability and completed 20 investigations. When appropriate we examine programmes at an early stage. We can then identify potential risks and comment on whether the projects are being developed to optimise value for money. The C&AG selects the areas for us to investigate.

**1.9** We do a range of other work to help the bodies we audit. This is our wider assurance work. This supports our overall strategic goal to improve public services. Our financial audits and reports form part of a wider integrated assurance approach involving a more proportionate and risk-based approach and an extensive range of outputs and products. The diagram overleaf summarises the range of our work, including financial and VFM audit.





## 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.



### Authoritative

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

### Collaborative

We work collaboratively with both colleagues and 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.

## 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 our work and annually report on the impact it has made. The audited bodies concerned confirm the ‘impacts’ of our work and our external auditor also gives assurance on them.

**1.12** In 2013-14 we reported a financial impact of £1.1 billion savings to government departments. We surveyed all our audit clients asking them to rate the quality and value our audit work added to their organisations. Respondents reported that they view the NAO as fair and balanced, and more of our clients consider that our recommendations and advice change the way they work. They gave an average score of 3.45 out of a possible score of 4 for the effectiveness of our reports in promoting or reinforcing positive changes in their organisations. We achieved an improvement in clients’ feedback ratings compared with 2012-13, with 87% of bodies we audited reporting that our judgements are fair and balanced, and 95% that they consider their relationship with us to be good.

**1.13** As well as financial impacts, we engage with the government to improve financial management, thereby making public services better. We report the financial and wider impacts of our work each year in our annual report.

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### We helped the Department for Environment, Food & Rural affairs improve the production of their financial statements

We wrote a report that reviewed how the Department and its network bodies produced their financial statements, and a best practice guide to assist management in reviewing the annual report and accounts. Our recommendations helped the Department improve its accounts production, enabling the annual report and accounts to be published in a timelier manner.

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### We helped the BBC improve value for money for the TV licence fee payer

Our examination of severance and wider benefits for senior BBC managers found that weak management controls had led to poor value for money. In response the BBC Trust and Executive Board reviewed their governance systems and are aiming to provide better oversight of how licence fee income is spent.

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### We investigated the Ministry of Justice’s electronic monitoring contracts

We produced a report that found that contractors were charging the Department for significant periods after the electronic monitoring activity had ceased; over similar timescales when electronic monitoring had never occurred; and multiple times for the same individual.

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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 C&AG, supported by the NAO, undertakes around 430 financial statement audits each year. These vary in size from large government departments, such as HM Revenue & Customs, to small incorporated subsidiaries of government-owned charities. The C&AG is appointed by statute to audit all government departments, agencies and most non-departmental public bodies. This means that he is the sole auditor of central government bodies. Details of the bodies we audit are available on our [website](#).

**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 and holds the government to account and helps public bodies to improve the way they provide services. Our VFM audits also show the public 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 2013-14, we have increased our contribution to improving public services, and broadened our product range accordingly. As well as using our value for money and financial audit work to assure Parliament, we have provided a wider range of assurance products – in particular 20 targeted investigations – to help us secure impact. 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 to improve public services.

**2.5** The leadership team is supported by the audit practice and quality committee (APQ). This oversees our policy on the technical quality of our work. It makes sure that our methodologies and audit approaches are fit for purpose and meet good practice. It also scrutinises quality assurance arrangements.

**2.6** The C&AG has overall responsibility for the NAO's system of quality control. 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. The NAO is organised into clusters, which group teams working together on clients with a common strategic issue. Each cluster has a designated quality lead that provides support and guidance to the cluster on the NAO's quality assurance arrangements, with particular focus on high risk audits and assurance products. The quality leads are members of APQ. The director general is guided by APQ and is advised on matters relating to audit policy and quality by groups of senior audit practitioners.

### Independence

**2.8** We must uphold high standards of ethics and probity, and work within a framework of values that preserve audit independence. This is essential if our work is to have the impact required. In carrying out our work we adhere to the values described in paragraph 1.10.

**2.9** We expect staff to comply with the relevant internal and external quality standards for our work. These include International Standards on Auditing (ISAs) (UK and Ireland), our VFM standards, Ethical Standards for Auditors published by the Financial Reporting Council (FRC) and international standards on quality control for audits (ISQC (UK and Ireland) 1). The director general audit quality is responsible for ensuring compliance with these standards 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 the independence and objectivity of engagement teams could be, or seen to be, threatened. All staff must attend training on the ethical and professional standards that we must meet. They must also provide an annual declaration confirming 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 body cannot replace us as auditors 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. Income is received for international cooperation work. This income is designed to cover costs and the work does not impact on the operations of any statutory body which we audit. However, income for this work may be provided directly or indirectly by a UK government body. We assess the safeguards required for the audit of the UK government body on a case by case basis. We have detailed procedures embedded in our financial audit methodology to identify potential threats to our independence and establish appropriate safeguards. We also fully implement (and extend) the standards' safeguards whenever appropriate. For example, to prevent over-familiarity of audit staff with the client, we rotate senior staff on financial audit.

**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 they do not align to our circumstances. The main area of divergence is in secondments. The ethical standard prohibits senior secondments to 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 private sector 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 apply enhanced safeguards for example, extra independent reviews of the audits.

**2.14** The audit quality review team (AQR) has highlighted that our secondments policy does not reflect the requirements of the ethical standards. We are discussing this with the FRC, to decide whether particular requirements of these standards are suitable for a statutory public sector audit body.

## Our people

**2.15** We are able to provide high-quality work because we invest in recruiting, developing and retaining the right people. Most people working in financial audit are either CCAB qualified or in training for a CCAB qualification. We also use specialists to support audit teams, for example statisticians and IT specialists. Many staff engaged in VFM audit previously trained as accountants. We recruit analysts and senior analysts from many specialist 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.

**2.16** We have implemented a comprehensive skills strategy. This ensures that we develop expertise to address the strategic issues of all of our audited bodies. In 2013-14, we also recruited expertise in local government, corporate finance, health and IT within a broad range of disciplines.

**2.17** The professional accountancy training for staff is supplemented by in-house training in both financial and VFM audits. All qualified financial audit staff working on financial audit must attend an annual technical update and have further training on specific areas, such as specialist accounting and central government audit. On average, people in the NAO undertook 5 days of structured training (excluding the training provided to support a professional accounting qualification).

**2.18** As well as the comprehensive training programme, we have a secondment programme to the public and private sectors. This is an important programme, which develops staff, increases our knowledge of how government bodies work, and also benefits our clients by providing them with experienced staff.

## High-quality engagement performance

**2.19** Financial audit work follows a standardised format. However, our VFM assurance work is becoming increasingly varied as we aim to satisfy the needs of many audiences in government and Parliament. It can include 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 gagging clauses.

### **Value for money audit**

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

**2.21** Our standards set out the mandatory principles that all VFM studies must meet. These standards are based on best NAO practice. The standards 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 and Parliament. We also provide a detailed explanation of current approaches to implementing the standards. We will review and amend the standards as necessary to ensure they reflect developments in our VFM studies and wider products. Further details on the standards can be found in Appendix Two.

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

### **Financial audit**

**2.23** All our audit work is conducted under 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 (UK and Ireland) 1. Meeting these means that our financial audit work also complies with the relevant International Standards of Supreme Audit Institutions (SSAIs) established by the International Organisation of Supreme Audit Institutions (INTOSAI).

**2.24** We engage widely with the accountancy and auditing professions, through the professional institutes, with other UK and international public audit bodies and with 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. In addition, the NAO and its staff are appointed to a wide range of professional bodies and committees; including the FRC's 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.

**2.25** Our audit methodology is outlined in the financial audit manual. 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 can be found in Appendix Two.

**2.26** We updated our audit methodology for 2013-14 audits. The changes were designed to ensure that our approach focuses on key areas of risk and provides greater insight to the bodies we audit.

**2.27** We build quality control into all stages of a financial audit to ensure that the work is of the highest technical standard. We extensively review the work and there are a number of specific review stages. All work undergoes a 2-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 consisting of senior practitioners will be convened to consider all qualifications and significant technical judgements.

**2.28** We also complete an annual quality assurance programme to ensure that we comply with the financial audit manual and ISQC (UK and Ireland) 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.

**2.29** The findings of these reviews are mainly qualitative. They 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, when appropriate, incorporate them into further guidance or training, or both.

**2.30** The internal cold review process in 2013-14 identified potential improvements to how we audit accounting estimates and how we document the reliance placed on others. We are taking targeted action to implement these improvements. We are also seeking to integrate training materials and further guidance into the software we use to document our work.

**2.31** 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 adversely affect the performance assessment of directors and their teams.

## External monitoring for high-quality audit

**2.33** A practice and quality team considers the results of the external monitoring and feedback from audit clients and reports them to APQ. The director general also reports annually, to the leadership team and board, the results of the quality assurance process on key quality issues.



### **External monitoring – value-for-money studies, 2013-14**

**2.34** Each year external specialists review a sample of published VFM studies (19 in 2013-14). Oxford University's Said Business School (trading as ISIS Innovation), RAND Europe and Risk Solutions have been appointed 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.

**2.35** Our analysis of our performance in 2013-14 shows that the overall quality of our audits has increased. Our independent reviewers noted examples of good practice in the structure and presentation of our reports, collection and analysis of data and linkage between findings and recommendations. Our reviewers also highlighted some areas for development: these included how well our reports drew out wider lessons or comparisons; and how clearly reports presented data and any associated limitations or uncertainties.

### **External monitoring – financial audit, 2013-14**

**2.36** Each year, the Financial Reporting Council's AQR team inspects our work. Further details of these monitoring arrangements can be found in Appendix Two.

**2.37** In 2013-14, the AQR reviewed 6 of our audits, and we responded to its findings. The AQR also reviewed policies, processes and procedures supporting audit quality. This considered methodology, related training (including in relation to IT audit) and guidance. The inspection also considered the actions taken on findings arising from the 2012-13 review.

**2.38** The AQR noted that professional scepticism and audit quality are embedded in audit guidance and training. The AQR also highlighted that our guidance permitted levels of performance materiality that exceeded those used by major private sector audit firms. The highest permitted level was only applied in a small number of lower risk audits. We have since amended our guidance in this area.

**2.39** The AQR concluded that overall audit quality has improved but noted concerns about one audit in a number of areas. They continued to highlight that our policy on secondments did not comply with ethical standards. The Financial Reporting Council is updating the ethical standards and we will be providing comments to reflect the circumstances and threats faced by a statutory public sector audit body.

**2.40** The detailed findings from the AQR review of audit files highlighted areas that needed further action. The most significant of these included the audit and documentation of significant accounting estimates, for group auditors to consider omissions in returns from component auditors and for audit teams to select and document the testing of journals based on the risk of material misstatement. We communicated the AQR's findings to all staff. We also updated the standard audit documentation so that the issues would be addressed consistently across all audits.

# Appendix One

## Governance and structure

### **Governance and accountability**

**1** Effective governance is vital to an organisation's success. We work to uphold high standards of governance in our operations and decision-making. It is also an essential part of developing and implementing 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. They also reflect Parliament's wish that our governance should independently control and oversee our operations, while preserving the C&AG's independence in making audit judgements.

**3** Most members of our board are 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, on 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 alone has the authority to exercise audit judgements and reach opinions.

**4** The C&AG is also appointed by the Queen under letters patent on the recommendation of the Prime Minister and the chair of the Committee of Public Accounts. The Act requires that he sits on the board, with 3 other executive members, who are nominated by him and appointed by the non-executive members.

During 2013-14, our board members were:

- Sir Andrew Likierman (Chairman);
- Amyas Morse (C&AG);
- Gabrielle Cohen (Executive Leader, Stakeholder Relationships);
- Naaz Coker (non-executive member);
- Paula Hay-Plumb (non-executive member, chair of the Remuneration and Nominations Committee);
- Gillian Guy (non-executive member, chair of Audit Committee from 16 May 2013);
- John Thorpe (Executive Leader, Economic Affairs) (joined the board in March 2014);
- Dame Mary Keegan (non-executive Member, chair of Audit Committee until 16 May 2013);
- Ed Humpherson (Executive Leader, Economic Affairs) (term of office ended December 2013); and
- Michael Whitehouse (Chief Operating Officer).

The board is supported by 2 committees, both of which consist solely of non-executive members.

### Audit committee

**5** 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 VFM report on the NAO.

### Remuneration and nominations committee

**6** The committee determines the framework for remunerating the 3 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.

**7** There is a clear division of responsibility between the Chairman and the C&AG. The Chairman is responsible for leading the board and its effective working. The C&AG is responsible for implementing the strategy, making audit judgements, deciding a programme of VFM examinations and reporting the results to Parliament.

**8** 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 extra rigour and discipline to decision-making and bring insight from their wider experience to inform our thinking and support improvement.

**9** The board meets 8 times a year to discharge its responsibilities, which are set out in the Act and complement the C&AG's responsibilities. The board attends 2 Strategy Days in the year, to focus on the NAO's strategic objectives and progress against the strategy. The board, with the C&AG, prepares the strategy, an estimate of resources required for each financial year, and an annual report on our activities. The board must also recommend an external auditor for appointment by the Public Accounts Commission.

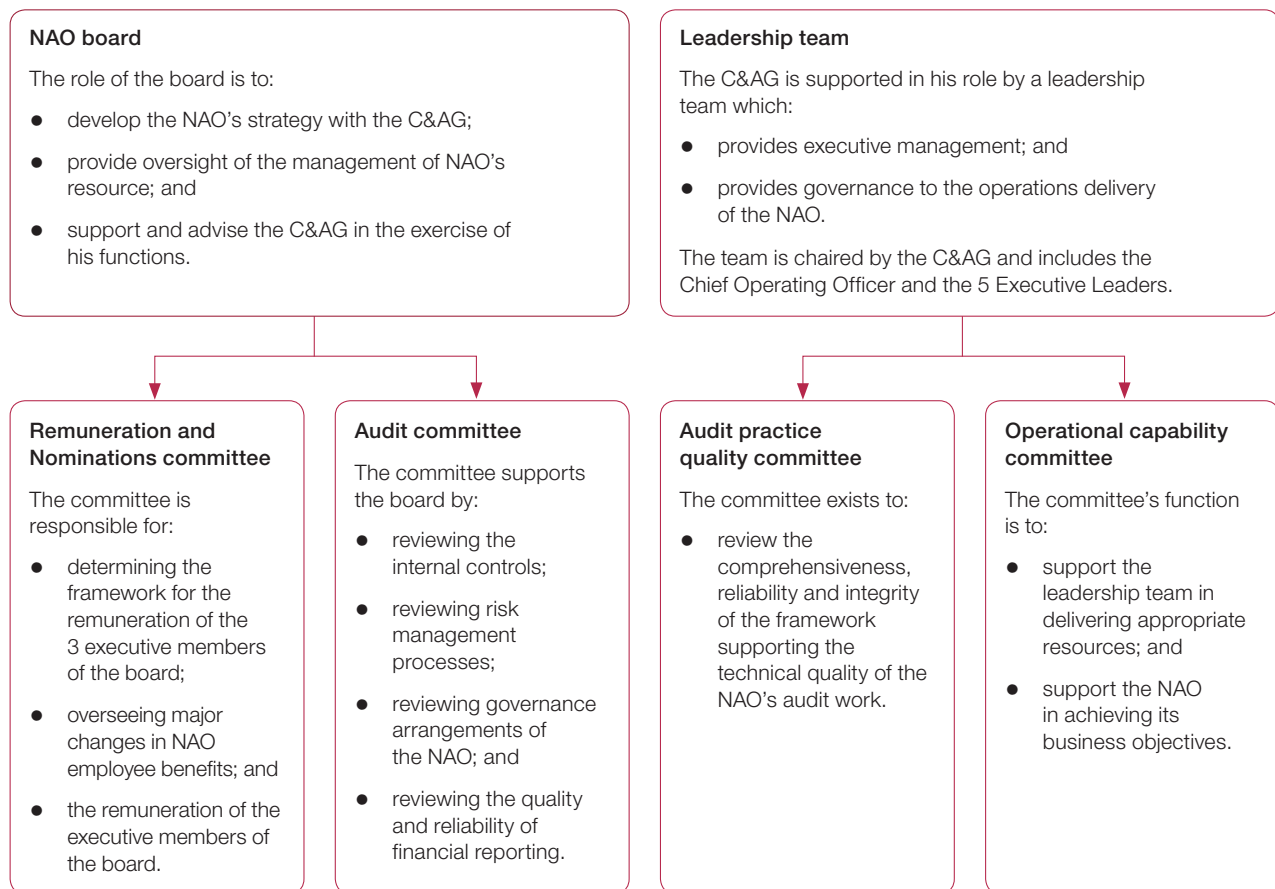
**10** The board is responsible for approving the programme of work undertaken outside of the C&AG's statutory responsibilities. This programme of work includes those financial audits undertaken under the Companies Act 2006, the value-for-money review of the BBC, and our work with international organisations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

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

**12** The NAO is accountable to Parliament, via the Public Accounts Commission. The Commission's role is defined by both the National Audit Act 1983 and the Budget Responsibility and National Audit Act 2011. Its principal duties under the Acts are to examine the NAO estimate of resources and lay it before the House, to consider our strategy, to appoint our auditor and receive their reports and to appoint non-executive members of the board.

**13** Our formal governance structure is as follows:**National Audit Office governance structure**

**The Public Accounts Commission** is formally responsible for: the approval of the NAO's strategy and setting the NAO's budget; the appointment of the non-executive members of the NAO board; and the appointment of the NAO's external auditor.



## 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 8 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

**14** Our strategy is to use the insights we derive as the government's external auditors to help improve public services. We are organised into clusters, which group teams working on clients with a common strategic issue. This makes us more effective in sharing our knowledge and developing expertise in specific strategic issues, which benefits the government and Parliament. The 6 clusters are:

- mass market operations;
- influencing and regulating;
- local delivery through networks;
- local service delivery and user experience;
- effective strategic centre; and
- delivering major long-term projects.

**15** We have further developed the range of assurance products we offer – in particular we have improved our investigative capability, and now have a core team focusing on matters of irregularity and responding to concerns raised by Parliament and the public.

## People

**16** We employed an average of 822 full-time equivalent permanent staff in 2013-14. Most of our staff are qualified or trainee accountants and over 60% are members (or trainees) of the main accountancy institutes. Their expertise is supported by other staff with specialisms in, for example, economics, statistics and information technology.

**17** We are a registered trainer for ICAEW. In addition, we provide professional training for employees taking the ACCA, CIMA and CIPFA qualifications. We recruit and train about 70 trainees a year, who undertake structured training towards becoming chartered accountants through ICAEW.

**18** In 2013-14, our trainees again achieved a high level of success at the ICAEW examinations with pass rates continuing to meet or exceed the national average. One of our graduate trainees, Shelina Alagh, won various ICAEW awards including one for the quality of her work in the national Financial Management examination, in which she secured first place.

**19** We give all staff suitable training, for continuing professional development. As well as flexible and efficient online and e-learning tools, we have development programmes for high-potential staff to prepare them for future leadership positions.



**20** Continuing 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, the pressures of providing services or different approaches to performance assessment. This is valuable in providing insight into how the government works and helping our staff to formulate useful and practical recommendations in our reports. We take care when redeploying staff on return, to avoid conflicts of interests.

**21** There is managed progression through the staff grades. We have 2 development programmes to identify and support individuals of high potential. The future leaders programme is aimed at those at an early stage in their career. The direct programme is aimed at managers with the potential to become directors.

**22** We publish an organisation chart showing our structure and seniors managers' responsibilities on our website. In 2013-14, the staff distribution by grade was as follows:

Grade	Percentage
Leadership	2
Director	6
Manager	17
Lead	38
Trainee/other	37

**23** We give staff suitable training opportunities to ensure continuing 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.

**24** We are independent of government pay policy. However, 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. The largest non-pay benefit (aside from professional training) is the civil service pension scheme.

**25** 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

**26** We are conscious of the need to practise what we preach on financial management and value for money. Our external auditor, Baker Tilly, undertake an annual VFM review of a particular aspect of our activities or systems. This year they focused on our management information. Their report concluded that this was generally fit for purpose but made a number of recommendations to help us prepare and use the information more efficiently and effectively. These recommendations were accepted by management, and action has been taken during the year to address them. This has included improving and simplifying the management information presented to the board.

**27** Our full financial information is contained in our *Annual Report and Accounts 2013-14*, which can be found [here](#). In summary, see table opposite.

**28** Our annual report contains a detailed remuneration report. We also publish details of senior staff [remuneration](#), the travel and subsistence costs incurred by the leadership team and board members and the hospitality they provide and receive.

## National Audit Office operating segments

	2013-14						Total
	Financial audit	Value for money	Insight and investigations (formerly Performance improvement)	Support to Parliament, the public and other organisations	Comptroller function	Restructuring	
	£000	£000	£000	£000	£000	£000	
Gross expenditure	46,915	17,617	13,047	7,125	205	4,206	89,115
Income from services provided	(16,184)	–	–	(2,462)	–	–	(18,646)
Rental income	(920)	(346)	(256)	(140)	(4)	–	(1,666)
<b>Net expenditure</b>	<b>29,811</b>	<b>17,271</b>	<b>12,791</b>	<b>4,523</b>	<b>201</b>	<b>4,206</b>	<b>68,803</b>

The NAO reports expenditure and income on its provision of Audit and Other Assurance Services under 5 strategic objectives, full descriptions of which can be found on pages 16 to 23 of our annual reports and accounts. In 2013-14, there was an additional £4.2 million expenditure on restructuring. This has been shown as a separate item because the funding was 'ring-fenced'.

Gross expenditure includes all voted and non-voted expenditure.

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 on secondments and international technical cooperation work.

Rental cannot be directly attributed to the NAO's front-line objectives and has been apportioned.

	2012-13						Total
	Financial audit	Value for money	Performance improvement	Support to Parliament, the public and other organisations	Comptroller function	Restructuring	
	£000	£000	£000	£000	£000	£000	
Gross expenditure	49,342	17,448	15,108	7,144	199	–	89,241
Income from services provided	(18,227)	–	–	(2,012)	–	–	(20,239)
Rental income	(785)	(250)	(108)	(125)	(2)	–	(1,270)
<b>Net expenditure</b>	<b>30,330</b>	<b>17,198</b>	<b>15,000</b>	<b>5,007</b>	<b>197</b>	<b>–</b>	<b>67,732</b>

## 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, he can report to Parliament on matters that might otherwise have caused him to withdraw from the engagement. No such instances arose in 2013-14.
- 2** Where the C&AG is appointed as auditor other than by statutory appointment, the board considers the appointment. 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, including the right to decline or withdraw from any of these engagements. He is advised by the relevant engagement director and the director general audit quality in engagement acceptance matters.
- 3** For all the audits we consider, on appointment and in each successive year, there are issues that might increase or decrease risk. 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 ISAs (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 that 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. This software, along with other tools and templates, makes it straightforward for engagement teams to comply with standards and internal policy. It also encourages 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 need approval from the central practice and quality team.

## Control framework

**6** Overall responsibility for a financial audit rests with the engagement director. We use a 2-stage internal review process for all audits to ensure the quality of the 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** When an engagement director identifies a matter that involves significant professional judgement, they must consult the practice and quality team, led by the director general audit quality, before concluding on the matter.

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

**9** Some engagements are assigned an engagement quality control reviewer (EQCR), who is a financial audit director independent of 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. They 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 the 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. The work of each financial audit director is covered every year and of each engagement manager every 3 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 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 next audit cycle; and
- the consistency of message and appearance of client-facing documentation.

## **Training and technical competence**

### Training

**12** The director general audit quality ensures that appropriate in-house training is given to financial audit staff. This supports the professional accountancy training given to all trainee auditors.

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

**14** As part of their annual 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 previous experience. For example, in 2013-14, targeted training was provided in the following areas:

- ethics (including the use of professional scepticism);
- the audit of regularity and propriety; and
- group audits.

We have developed a 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.

### Audit licences

**16** 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 CCAB-qualified or exam-qualified.

**17** 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 receiving a specialist licence must hold a general audit licence, have an appropriate level of recent experience in the specialist area and have attended any relevant technical updates.

**18** Members of staff who do not hold the appropriate licence can hold senior roles within the engagement team, provided there are adequate supervision arrangements. 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. The engagement director must consult with the second director at regular points during the audit and before issuing the audit report.

## **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.

**20** These policies and procedures are underpinned by our VFM standards, which set out the expectations that all VFM studies must meet. VFM staff are expected to adhere to these standards and this is considered as part of the internal quality assurance process. There are 10 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 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 gathering information and developing and reviewing proposals. This ensures that proposals fit our objectives and Parliament's needs.
- Approving the study concept. The C&AG examines and approves a study concept, considering its 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 have reviewed the study plan.
- 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 provision audit findings and the draft final report. When he authorises it, the team sends the draft to the audited body for consideration and comment.
- Copy editing and data presentation review. The copy editor edits the draft report before publication. This is to ensure readability and adherence to our standards.
- 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 learned. These are then disseminated across the organisation.
- Internal cold review. A sample of 5 – 10 audits each year are peer-reviewed against a standard set of criteria to identify how well they have met the VFM standards. Each VFM team is examined regularly. 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 reports (19 in 2013-14) are subject to an independent, external review. The reviewer considers the report against a set of agreed criteria (further details overleaf).

## 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 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 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 also fund more complex technical courses run by external training providers and specialists in technical areas.

## External monitoring

### External review – financial audit

**23** The AQR team of the FRC reviews our whole-office procedures and a selection of audit files. In 2013-14, the AQR reviewed 6 completed audit files (2012-13: 6), of which 2 (2012-13: 2) were performed under the Companies Act 2006.

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

### External review – VFM reports

**25** For 20 years we have used external specialists to review VFM reports. In 2013-14, a sample of our reports was reviewed by independent experts from Oxford University Said Business School (trading as ISIS innovation), Risk Solutions/Cass Business School and RAND Europe.

**26** Our reviewers assess the report against a set of 9 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; and
- appropriateness of recommendations.

**27** They provide a written review assessing how each report meets professional standards against each criteria and give an overall assessment. Since September 2010, they assessed a sample of reports and also reported on specific themes, such as the quality of drafting and how we use evidence. APQ uses these reviews as the basis of discussions on quality.

**28** Our central practice and quality team also seeks formal feedback from clients on individual studies on a range of issues. These 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 audited body when our report is published. This gives us better and more timely feedback.



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