



National Audit Office

NATIONAL AUDIT OFFICE

TRANSPARENCY REPORT 2016-17

DECEMBER 2017

Our vision is to help the nation spend wisely.

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

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £734 million in 2016.

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This report can be found on the National Audit Office website at www.nao.org.uk

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INTRODUCTION

This Transparency Report has been prepared to meet the provisions in the Statutory Auditors (Transparency) Instrument 2008 (the Instrument). The National Audit Office Board endorsed this report on 16 November 2017.

FOREWORD

From the Comptroller and Auditor General

The National Audit Office (NAO) helps Parliament to hold government to account and in so doing, improve public services. We provide system-wide, integrated and independent public audit. We look across the public sector, one audit judgement building upon another with a clear view of the public interest. We recognise that this is a unique, privileged position, and we seek always to use it responsibly, as Parliament intended.

The public sector faces considerable challenges, having to deliver high-quality services with fewer resources, and is constantly undergoing change. To be able to deliver, government departments are changing the way they operate, through increased devolution, partnerships with the private and third sectors and through transformation projects enabled by digital technologies. This level of change brings opportunities for efficiencies but also challenges to accountability and securing value for money. At the same time, departments face added challenges in prioritising resources stemming from government's commitments to major infrastructure projects and the UK's decision to leave the European Union.

The NAO must stay ahead of challenges faced by public services and bring the best knowledge, skills and insight to every audit we do so Parliament and the bodies we audit can have confidence in our findings. To offer the best quality and most relevant outcomes, we continue to develop our digital capability, both in how we deliver our financial audits and to have the expertise to provide Parliament with in-depth, value-for-money assessments in those we audit. We have also improved our influence by engaging in new ways with those we audit and being more responsive in tailoring our work to our audiences. The last year has also seen the NAO take on new audit responsibilities including for the BBC, the Bank of England and UK Asset Resolution Ltd.

Our values and strong focus on the development of our people remain essential to our organisation. We continue to value diversity, equality and to promote an inclusive environment where our people feel respected and valued.

Our Annual Report and Accounts for 2016-17 set out the progress achieved during the year. This Transparency Report complements our Annual Report and Accounts by showing how our audit work was of the highest quality and met the highest professional standards expected of us as well as ensuring that we remained accountable to Parliament.

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



Sir Amyas C E
Morse KCB

Comptroller and
Auditor General
National Audit Office

PART ONE

ABOUT US



**Daniel
Lambauer**

Executive Leader,
Strategy and Operations

We help Parliament hold government to account for spending public money. In so doing, we help improve public services for all.

We bring together our value-for-money and financial audit work to provide integrated, system-wide public audit services for Parliament. We shed light on how public bodies operate and use their resources.

By understanding the public sector as a whole, we also help public servants understand best practice, Parliament to understand better the practical effects of policies on the ground and government to draw better connections between its decisions.



John Thorpe

Executive Leader

Daniel Lambauer
Executive Leader, Strategy and Operations

John Thorpe
Executive Leader

Comptroller and Auditor General

1.1 The Comptroller and Auditor General (C&AG) is appointed by Her Majesty the Queen as an Officer of the House of Commons. The appointment is 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 from entities he audits.

1.2 To preserve his independence from government, the C&AG has complete discretion in carrying out his functions. 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 2016-17 governance and structure in Appendix One: Governance and accountability.

1.3 Both the C&AG and his staff are independent from the government. We are not civil servants and do not report to a minister. We report objectively and independently on what the government does and do not advise on policy or on the specific decisions the government takes.

Our role

1.4 We scrutinise public spending for Parliament by fulfilling our statutory roles in financial audit and value-for-money reporting across central government and local bodies. 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 work to Parliament, we hold government departments and bodies to account for how they use public money, thereby safeguarding taxpayers' interests. Our work also helps public service managers improve performance and service provision.

KEY FACTS

1,027
pieces of correspondence
processed

KEY FACTS

372accounts certified

1.6 Through our financial audit work, we audit the financial statements of a wide range of institutions, including all central government organisations, and report on them to Parliament. In 2016-17, we certified 372 accounts with audited expenditure amounting to £1.7 trillion.

1.7 We also examine particular areas of 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 2016-17, we published 68 VFM reports on key government initiatives and the current challenges government faces.

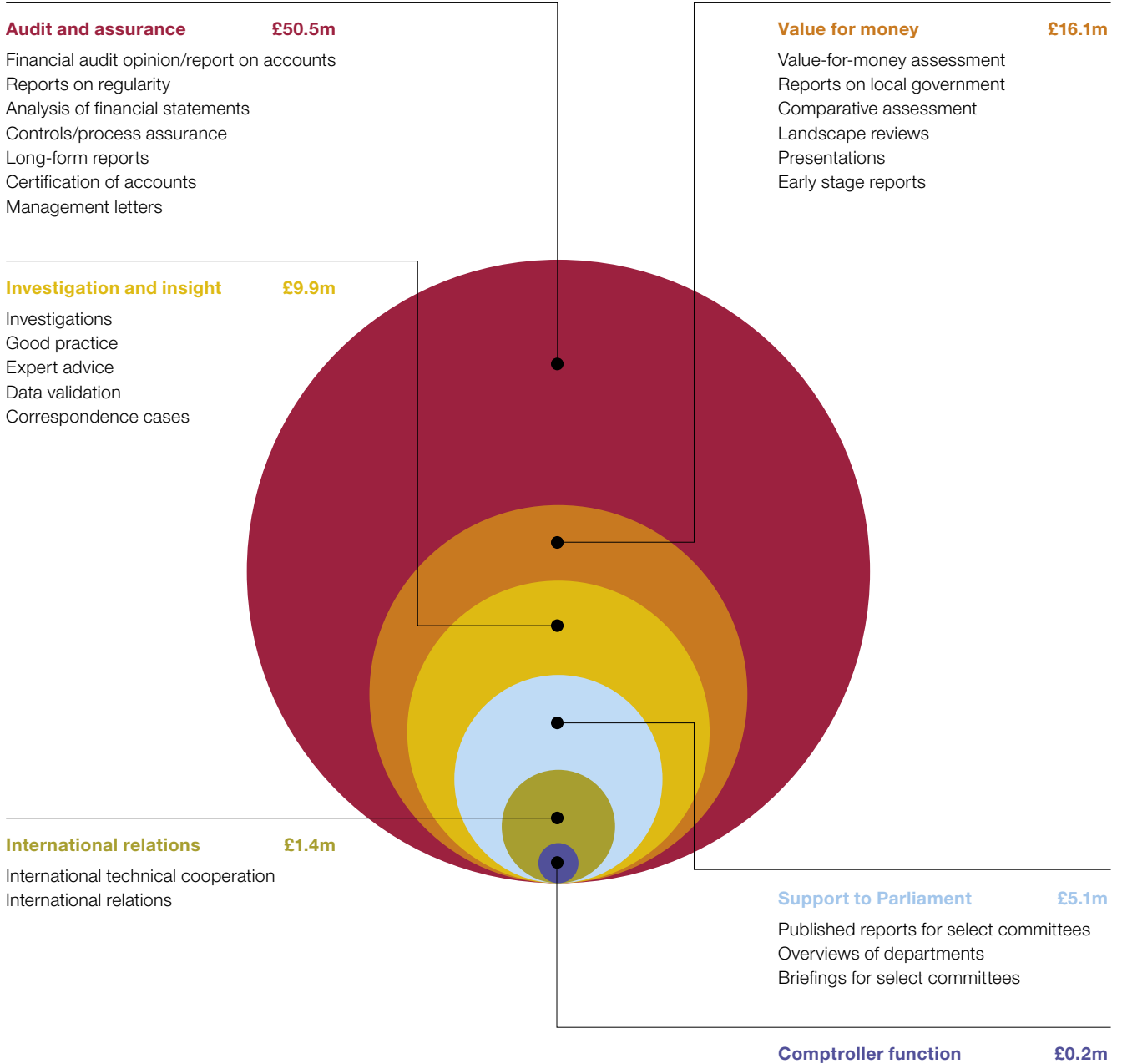
1.8 We also conduct responsive, focused and facts-based investigations in circumstances where concerns have been raised with us, or in response to intelligence gathered through our wider work. Investigations allow us to provide a rapid account of a situation or issue and give us an opportunity to add our voice to 'live' issues where public funds were, or continue to be, at risk. Investigations promote transparency, accountability and good governance within the public sector. The C&AG decides on topics to investigate, and during 2016-17 we published 18 investigations and supported five Committee of Public Accounts evidence sessions through our investigative work.

1.9 We also report on the value for money of public spending locally, under the Local Audit and Accountability Act 2014. We are responsible for the Code of Audit Practice, which sets out what local auditors need to do to meet their statutory responsibilities. This code and its guidance support auditors and underpin a consistent high-quality approach to auditing local public bodies.

1.10 As well as certifying accounts, we also carry out wider assurance work, including checking grant claims and reviewing IT systems. Increasingly, we are using the knowledge and insight gained from our financial audits to inform and integrate into our other work, such as our value-for-money reports and investigations. *Our strategy 2017-18 to 2019-20*¹ sets out how our public audit perspective helps Parliament hold government to account and improve public services. The diagram summarises the range of our work, including financial and VFM audit.

1 National Audit Office: *Our strategy 2017-18 to 2019-20*, December 2016, available at: www.nao.org.uk/wp-content/uploads/2016/12/NAO-strategy-2017-2018-to-2019-2020.pdf

The range of our work



KEY FACTS

68

Value-for-Money
reports published

Our values

1.11 Our values underpin everything we do and how we behave with the bodies we audit, with other stakeholders and with each other.



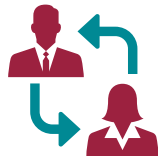
INDEPENDENT

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

1.12 Our programme of work and balance of effort are carefully planned to produce the outputs needed to support Parliament in its scrutiny of public spending and to improve public services. We also use our work to help the organisations we audit make progress with the strategic issues they face. We measure and report annually on the impact of our work. The audited bodies concerned confirm these impacts and our external auditor also gives assurance on them. In 2016-17 we reported a financial impact of £734 million savings to government departments. In addition to financial impacts, we engage with the government to improve financial management, thereby improving public services. We report the financial and wider impacts of our work each year in our annual report, which can be found on our [website](#).

1.13 We also monitor Treasury Minutes documenting the government's response to PAC recommendations. We further monitor and discuss regularly with departments the implementation of our own recommendations across government as an additional measure of our impact. This helps to identify systematic issues and serves to further focus our work.

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

1.15 In 2016 we made substantial changes to the feedback process, enabling us to gather more comprehensive insights from a wider selection of organisations. Overall, the independently conducted survey showed that the bodies we audit remain very satisfied with the NAO: 94% of respondents agreed that their overall relationship with us was good or very good. Respondents have a very high regard for our financial audit work, with 92% agreeing it is of high quality and 85% saying that they would actively seek our feedback on accounting and financial control issues. Of those respondents directly involved in value-for-money studies, 73% rated the quality of their most recent value-for-money study as good or very good.

1.16 Each year, we commission a survey of MPs' opinions of the NAO. Of those MPs who are familiar with the NAO, more than eight in ten believe that we are "above average" for acting with authority, impartiality and independence, and honesty and integrity.

KEY FACTS

18

investigations

20

studies on local
service deliveries

Our influence

The quality and expertise of the NAO is widely recognised.

Our client feedback research in 2016 includes scores from interviews with 236 respondents, across 152 audited bodies.



of respondents rated our financial audit work as fairly good or very good



would like the NAO to do more to help public services improve by sharing good practice and guidance



of those involved in a value-for-money study rated the quality of their most recent study as fairly good or very good



of the respondents agreed that we place the right emphasis on holding government to account and providing high-quality audits

Not all beneficial changes from our work can be quantified. The examples of case studies below capture some of the qualitative improvements we bring about.

Improving value for money of free childcare

In March 2016, our report *Entitlement to free early education and childcare* concluded that the Department for Education (the Department) had made significant progress in delivering 15 hours of free childcare to parents of three- and four-year-old children and disadvantaged two-year-old children. However, implementing the commitment to double the entitlement to 30 hours would be challenging. In particular, without great care, disadvantaged two-year-olds, who benefit most from free childcare, could lose out. We concluded that, to prove the value for money of the new entitlement, the Department needed to set out clearly what it expected to achieve from offering extra hours of free childcare and measure progress towards these goals.

Impact: The government committed to roll out the extended entitlement a year early in eight local authority areas and to consider the recommendations in our report as part of this trial phase. The Department also agreed to evaluate the early implementation of the new entitlement. It has created a team to oversee local authorities' work to deliver the extended entitlement, which aims to ensure that there are enough places and that disadvantaged families do not miss out. It has issued an early years workforce strategy and agreed to publish the measures that it will use to evaluate the policy in the longer term.

Greater transparency on accountability across government

In February 2016, our report *Accountability to Parliament for taxpayers' money* concluded that, while public services have become increasingly complex, the essential elements of accountability have tended to be an afterthought. Furthermore, we concluded that accounting officers at the head of government departments had too little incentive to prioritise value for taxpayers' money compared with the incentive to satisfy ministers. Accounting officers were allowing projects and initiatives to proceed unchallenged, despite significant concerns arising about value for money.

Impact: While the government maintained that accounting officers often provide advice to ministers on value for money that is not visible externally, it agreed that the transparency and accountability of accounting officers' decisions could be strengthened. All departments will now publish, in an accounting officer system statement alongside the annual report, an explanation of all their accountability relationships and processes, from 2017 onwards. Accounting officers will also provide Parliament with positive assurance over the regularity, propriety, value for money and feasibility of major projects within the government's Major Projects Portfolio when they begin and again during implementation if they exceed expected levels of cost, benefit, timescale or risk. Summaries of these assessments will be published.

Enhancing performance measures for apprenticeships

Our October 2016 report *Delivering value through the apprenticeships programme* recommended that the Department for Education (the Department) should have much better ways of measuring the success of the programme, aside from the target of three million new apprenticeship starting between 2015 and 2020.

Impact: In response to our recommendation, the Department developed a comprehensive set of performance measures, covering aspects such as apprentices achieving higher earnings and more apprentices from disadvantaged backgrounds undertaking higher-value apprenticeships. These were set out in the programme's benefits realisation strategy, which the Department published in March 2017. The Department will publish its performance against these measures as the programme develops. Focusing on these measures should improve the quality of the Apprenticeships programme. It will also make it easier for people to hold the Department to account for the way it is running the programme.

KEY FACTS

62

Committee of Public
Accounts evidence
sessions supported

Improving contingency plans for the Emergency Services Network

In September 2016, we published a report on the Home Office's programme to replace the Airwave system, which the emergency services currently use to communicate, with a new Emergency Services Network (ESN). The report was an early look at the Department's plans to provide this critical national service and assess the risks the Department had taken on and how it was managing them. We concluded that the programme was five to ten months behind schedule and the Department should work on its contingency plans to extend the Airwave service.

Impact: In fieldwork for our report, the Department took on board our ongoing feedback, for example updating its risk registers and appointing new staff to help engage users. When the report was published, the Department acknowledged that our judgement was valid and is now updating its plans to ensure that the current service will be available to bridge the gap until ESN comes online.

PART TWO

AUDIT INDEPENDENCE AND QUALITY

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

KEY FACTS

£1.5m

income from our work with the United Nations

£0.5m

income from helping strengthen other Supreme Audit Institutions

Introduction

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

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

2.3 In addition to financial and VFM audits, we contribute to improving public services through the provision of other assurance products. For example, investigations are undertaken as a mechanism of timely and focused reporting to Parliament on emerging risks and issues of public concern, helping us secure influence.

2.4 The same principles of independence, quality and integrity apply to all our products.

Quality control

Leadership Team

2.5 The arrangements for the 2016-17 year are as explained below. The Leadership Team, chaired by the C&AG and consisting of chief operating officer and executive leaders, provides executive management and governance of the operations and delivery of the NAO's objectives. It ensures that we focus appropriate resources on the leading risks facing the public sector, and that this work supports our strategic goal of improving accountability and public services. By the end of 2016-17, we finalised a recruitment process for an enlarged Leadership Team, thereby extending its capacity to be directly involved with assignments where appropriate and increasing the opportunity to deliver direct value to our clients through deepening our relationships with the bodies we audit.

2.6 The Leadership Team is supported by the Audit Practice and Quality Committee (APQ), which considers the technical quality of our work. It makes sure that our methodologies and audit approaches are fit for purpose and meet good practice, and it scrutinises quality assurance arrangements. In the 2017-18 financial year, the APQ was dissolved and its responsibilities covered by two committees: VFM Quality Committee (advising the Leadership Team and providing oversight over all aspects of quality relating to the NAO's value-for-money and investigations work) and Financial Audit Director Group (advising the Leadership Team and providing oversight over all aspects of quality relating to the NAO's financial audit work).

2.7 Overall responsibility for the NAO's system of quality control ultimately rests with the C&AG. The C&AG has appointed the executive leaders as responsible for quality, reporting to the C&AG and the Board as appropriate. The C&AG and the Leadership Team are supported and advised by the Director of Financial Audit Practice and Quality and the Director of Value for Money Practice and Quality. These directors are the NAO's Heads of Professional Practice for their specialisms, holding operational responsibility for quality across our financial audit and value-for-money work respectively.

2.8 The C&AG and the Leadership Team are also supported by the Compliance and Quality Unit (CQU), and by Quality Directors within each cluster. The CQU has the key objective of monitoring compliance with professional auditing standards and the NAO's financial audit policies and the *Financial Audit Manual*. It also drives improvements in quality through review of audit work against best practice.

2.9 Appendix One: Governance and accountability and Appendix Two: Assurance and control explain how we are structured in more detail.

Independence

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

2.11 We expect staff to adhere to the relevant internal and external quality standards for our work. For 2016-17, this includes International Standards on Auditing (ISAs) (UK and Ireland), our set of standards for VFM and non-financial audit work, the Financial Reporting Council's Revised Ethical Standard 2016 (the Ethical Standard), in so far as these can be applied to a statutory public sector audit body, and International Standard on Quality Control for audits (ISQC 1). The directors of Financial Audit and VFM Practice and Quality are responsible for ensuring compliance with the relevant quality standards for their specialisms and for creating a culture of professionalism, rigour and openness to challenge.

KEY FACTS

803

full-time equivalent
permanent employees



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

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

Our people

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

2.15 We have implemented a comprehensive skills strategy. This emphasises the importance of learning new skills on the job. This ensures that we develop expertise to support the consideration of the strategic issues across the range of our audit bodies. In recent years, we have recruited senior-level expertise in local government, corporate finance, health and digital among a broad range of disciplines. We seek to disseminate this expertise across the NAO by promoting collaboration and knowledge sharing. We also support our people to acquire other relevant qualifications, such as those offered by the International Association for Contract and Commercial Management and the Diploma in Corporate Finance.

2.16 The professional accountancy training for staff is supplemented by in-house training in both financial and value-for-money audits. All front-line staff working on audit must attend an annual technical update and have further training on specific areas. In 2016 we also rolled out the first module of our “The Way We Work” training programme, a two-to-three year development programme that supports people in developing their personal, management and team-working skills. On average, people in the NAO undertook 10 days of structured training during 2016-17. This includes training in areas of specialist accounting and central government audit.

KEY FACTS

10

structured training days
undertaken per person
on average

High-quality performance

2.17 Financial audit work follows a standardised format, as it conforms to International Standards on Auditing (UK and Ireland). Our VFM assurance work is varied, and becoming increasingly so, as we aim to satisfy the needs of many audiences in government and Parliament. It can range from traditional value-for-money reports evaluating major projects ex-post, to early looks at major programmes, to landscape reviews of particular policy areas, and briefings on specific issues. We also undertake investigations of specific issues, such as our work on the Department for Transport’s funding of the Garden Bridge.

Value for money

2.18 We expect staff to meet our quality standards set for VFM, as described below, which stipulate clear quality-review requirements and responsibilities within audit teams.

2.19 Our standards set out the mandatory principles that all VFM studies must meet, together with the guidance on current approaches to implementing the standards. These standards are based on current best NAO practice and 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. Further details on the standards are set out in Appendix Two: Assurance and control.

2.20 VFM studies are subject to a multi-stage quality assurance process involving a core of mandatory elements and a sample of studies undergo both internal and external review (see Appendix Two: Assurance and control for further information). Our internal cold review process checks adherence with the VFM and non-financial audit standards and identifies and disseminates lessons to improve our VFM work. The quality-assurance framework for investigations is aligned to that for VFM studies.

KEY FACTS

Diversity

80%

of promotions to director in 2016-17 were of women

Financial audit

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

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

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

2.24 We build quality control into all stages of a financial audit to ensure that the work is of the highest technical quality. We extensively review our work and there are a number of specific review stages. All work undergoes a two-stage review by senior members of the engagement team. Some audits that include significant audit judgements (including audits on which the opinion is expected to be qualified) undergo an engagement quality control review by an independent and experienced director. The allocation for this additional layer of review is dependent on the nature of the engagement, the identification of unusual circumstances or risks, the requirements of the laws and regulations and the size and complexity of the organisation. We place a premium on consultation-driven audit quality. Consultation meetings are held at the planning stage of our highest risk audits and Audit Panels are convened to consider all qualifications, significant audit judgements and C&AG reports. These meetings and panels comprise our relevant executive leaders, our Director of Financial Audit Practice and Quality and senior engagement team members.

2.25 In addition, we complete an annual quality assurance programme to make sure that we comply with the Financial Audit Manual and ISAs. Our Compliance and Quality Unit, which reports to the executive Leadership Team, coordinates a programme of hot and cold reviews that are completed before and after an account is certified respectively.

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

2.27 We have also introduced root-cause analysis to understand more deeply any areas in our work where we have identified scope for improvement in order to identify how we can strengthen further our audit practice. This helps us to identify transferable learning for the wider audit practice which we disseminate through training and support on thematic issues, including targeted training for those new to supervising or overseeing financial audits. Further details on the review and assurance processes and our actions to address areas where potential improvements to audit quality are set out in Appendix Two: Assurance and control.

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

External monitoring for high-quality audit

2.29 The Practice and Quality Team and the Compliance and Quality Unit consider and report the results of the external monitoring to the C&AG and the financial audit practice leadership team. Key findings are shared with colleagues across the wider NAO's Financial Audit and VFM practices.

External monitoring – value for money studies 2016-17

2.30 Each year, external specialists review a sample of published VFM studies. Oxford Business Schools, Risk Solutions and RAND Europe undertake this work. The reviews completed during 2016-17 examined 11 reports. The reviews considered the scope of the study, qualitative analysis, structure and presentation, graphs and statistics, methods used, synthesis of value-for-money conclusions, recommendations, systematic issues and overall perception.

2.31 Overall, the reviewers assessed reports as well structured and well written, with high ratings for how the team set the scope, objectives and evaluative criteria, brought analysis and conclusions together, used graphics to present data, and made recommendations. Reviewers noted some cases where we could have provided more details about our methodology and dealt more fully with systemic issues raised by our reports. Further details of these monitoring arrangements can be found in Appendix Two: Assurance and control.

KEY FACTS

Diversity

44%

of promotions to manager in 2016-17 were of women

External monitoring – financial audit 2016-17

2.32 Each year, the Financial Reporting Council's Audit Quality Review Team (AQRT) inspects our work.

2.33 The AQRT are required to inspect the work which we complete under the Companies Act and we voluntarily invite them to inspect the work which we complete under statute. In 2016-17, the AQRT reviewed six of our audits: two Companies Act audits and four government department and public body audits. The FRC also undertook follow up reviews of the NAO's whole of office procedures and financial audit methodology. The sample of six audits reviewed is a small, non-statistical sample. Although the sample is not statistically representative, it supports an independent review of our audit work which informs our understanding of areas where we can make ongoing improvements in the quality of our work.

2.34 We value the insights that the AQRT findings give us and we have taken action to develop our organisation-wide support to quality and our audit approach where appropriate. Further details of these monitoring arrangements, their findings and our responses can be found in Appendix Two: Assurance and control.

APPENDIX ONE

GOVERNANCE AND ACCOUNTABILITY

- 1 Effective governance is vital to an organisation's success. We work to practise what we preach by upholding high standards of governance in our operations and decision-making. It is also an essential part of developing and providing our audit programme. The Board supports and advises the Comptroller and Auditor General (C&AG) in meeting his statutory responsibilities, and oversees how we manage and use resources.
- 2 Our governance arrangements have been developed and implemented in accordance with the requirements of the Budget Responsibility and National Audit Act 2011 (the Act). The arrangements reflect our unique statutory position and Parliament's wish that our governance should independently control and oversee our operations, while preserving the C&AG's independence in giving audit judgements.
- 3 Our Board has nine members, with a majority of non-executive members including the chairman. It provides rigour and discipline in decision-making and brings insights from the wider experience of the non-executive members to inform the strategic thinking of the NAO. The Public Accounts Commission appoints the non-executive members, except for the chair, who is appointed by the Queen under letters patent, upon the recommendation of both the Prime Minister and the Chair of the Committee of Public Accounts. This ensures that the non-executive members are independent of our management, and that the chair has the confidence of both the government and the opposition in Parliament. The relationship between the Board and the C&AG is set out in more detail in our [Code of Practice](#).
- 4 The Act also requires that the C&AG sits on the Board, with three other executive members, who are nominated by the C&AG and appointed for a fixed term by the non-executive members.
- 5 The NAO undertakes periodic voluntary reviews of its governance against the *Code of Good Practice for Governance in Central Government* (the Code), published by HM Treasury in July 2011.
- 6 During 2016-17 our Board members and Leadership Team were:

NAO BOARD AND LEADERSHIP TEAM



Key to committee membership

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

1 Lord (Michael) Bichard KCB

Chairman of the NAO Board

Michael Bichard has served at senior levels in local government, including as chief executive of both Brent Council and Gloucestershire County Council. He then moved into central government, working as chief executive of the Benefits Agency and then as Permanent Secretary at the Department for Education and Employment. Since his retirement from the civil service in 2001, he has held a variety of posts, including chair of the Legal Services Commission, chair of the Design Council and founder Director of the Institute for Government. He is currently Chair of the Social Care Institute for Excellence and Deputy Speaker of the House of Lords.

2 Sir Amyas C E Morse KCB

Comptroller and Auditor General and member of the NAO Board

Sir 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 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.

3 Michael Whitehouse OBE

Chief Operating Officer and member of the NAO Board

Michael Whitehouse OBE was appointed Chief Operating Officer in July 2009. Michael has extensive experience of value-for-money work across government and internationally. Michael has responsibility for the strategy, capability and operational performance of the NAO, and leads the NAO's work on cross-government issues. Michael is chair of the Operational Capability Committee and is a qualified accountant. Michael retired in April 2017.

4 Janet Eilbeck

Non-executive member of the NAO Board and chair of the Audit Committee (from October 2016)

Janet Eilbeck was appointed to the NAO Board in October 2016 as a non-executive member. Janet is a chartered accountant with more than 30 years' experience. She was an assurance partner at PricewaterhouseCoopers until 2011, specialising in government and the broader public sector, including wide experience of internal audit. She was also chair of the Internal Audit Standards Advisory Board (IASAB), as well as being the independent financial expert for the Department for Education and Employment. She has been the chair of the NAO's Audit Committee since October 2016. Janet took over from Joanne Shaw.

5 Sue Higgins

Executive leader (left July 2016)

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

6 Dr Sally Howes OBE

Executive leader (left August 2016)

Sally Howes OBE joined the NAO in April 2010 as a director and was appointed as an executive leader in April 2013. For more than six years, Sally used her experience of business change and technology to guide the introduction of new approaches to learning, development and knowledge management and championed our communities of practice. Sally served as an executive member of the NAO Board for 2015-16 and has made an important contribution in ensuring that the NAO is recognised as a thought leader in the digital challenges which government faces. Sally left the NAO in August 2016 and has a portfolio of strategic consultancy and non-executive roles in digital and cyber.

7 Abdool Kara

Executive leader (from February 2017)

Abdool Kara was appointed to the Leadership Team as executive leader with strategic oversight of our work relating to local service delivery. Abdool brings a significant depth and breadth of experience from senior roles in local government and delivery of local services, as well as from his wider public sector accountability and inspection work. Before joining the NAO, he had been chief executive of Swale Borough Council since 2009.

8 Greg Parston

Non-executive member of the NAO Board (from October 2016 to May 2017)

Greg Parston was appointed to the NAO Board in October 2016 as a non-executive member. Greg is a senior manager and organisation consultant. He has much experience in governance, strategy and change management, skills which are required by the NAO Board. He has extensive experience in public service delivery and policy and has advised leaders in government, the civil service and charitable organisations around the world on how to improve social and economic outcomes. Greg is currently the senior adviser at the Institute of Global Health Innovation at Imperial College London. He is also chair of Dartington Hall Trust. Greg resigned in May 2017 due to his increasing external and overseas commitments.



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9 Joanne Shaw

Non-executive member of the NAO Board and chair of the Audit Committee (left September 2016)

Joanne Shaw is an experienced non-executive director and board chair with a background in private, public and third-sector organisations. She is a qualified accountant with expertise in strategic development and change management. She is currently Deputy Chair of Nuffield Health and Chair of the British Equestrian Federation. She was the chair of our Audit Committee until September 2016. Joanne Shaw left the Board at the end of September 2016 to join the Board of NHS England.



11 Robert Sykes OBE

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

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



10 Ray Shostak CBE

Non-executive member of the NAO Board and chair of the Remuneration and Nominations Committee (from January 2015)

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



12 Stephen Smith

Executive leader and member of the NAO Board (Board member from April 2016)

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



13 John Thorpe

Executive leader and member of the NAO Board (Board member from April 2016)

John Thorpe joined the Leadership Team in January 2014. He has experience across a range of portfolios throughout his NAO career including employment, agriculture and international, as well as the NAO's technical team. As a director he was responsible for our financial audit in HM Treasury and HM Revenue & Customs. John currently shares the responsibility for the leadership of the financial audit work-stream and NAO's international work.

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 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 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 of this work to Parliament.

9 The Board met formally seven times during 2016-17 to discharge its responsibilities, which are set out in the Act and complement the C&AG's responsibilities. During the year, the Board attended two Strategy Days, to focus on the NAO's strategic objectives and progress against strategy and discuss future scenarios for the way public services are delivered. Each year the C&AG and NAO Board agree the NAO Strategy and an estimate of resources required for each financial year, which are submitted to the Public Accounts Commission for consideration and approval. The NAO Board and C&AG also prepare an annual report on our activities, which includes our annual resource accounts. The Board must also recommend the external auditor for appointment by the Public Accounts Commission.

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

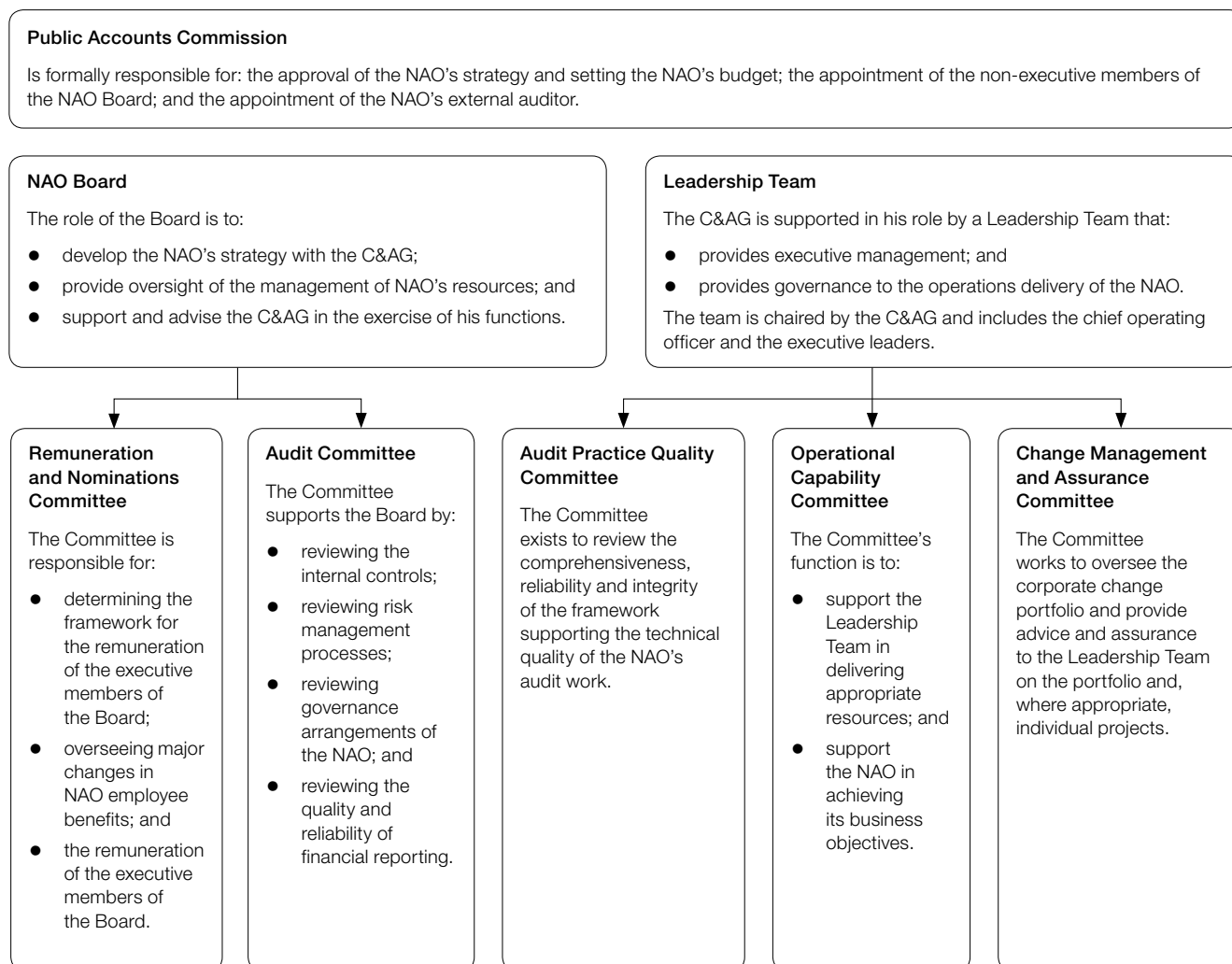
11 The NAO Board undertakes a review of its performance each year. During 2016-17, it carried out an external evaluation and review. The focus of this review was on the infrastructure and individual behaviours of the Board. The evaluation concluded at the Board's meeting in September 2016. The Board undertook a separate discussion at its meeting in January 2017 to discuss its compliance with its terms of reference.

12 The C&AG is supported in his role by the Leadership Team, who helps the C&AG 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 during 2016-17 is as follows:

National Audit Office governance structure



Review of effectiveness

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

- conducting a detailed risk-based Internal Audit Needs Assessment from which he has prioritised activity over a three-year planning horizon to design an Internal Audit Strategy;
- designing and populating a three lines of defence model to provide a bird's eye view of the assurance framework received by both my Leadership Team and the Audit Committee;
- designing and applying a risk-based methodology which is consistent with the requirements of the Public Sector Internal Audit Standards;
- delivery of 30 individual assurance assignments and advisory reports during the year and, where appropriate, agreeing an action plan with system owners to secure improvements; and
- monitoring the implementation of his recommendations throughout the year and assessed the progress as good.

16 The C&AG is able to report that there were no significant weaknesses in the NAO's system of internal controls in 2016-17 that affected the achievements of the NAO's key policies, aims and objectives.

Structure

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

18 We also benefit from six centres of expertise to support our work. These are decentralised groups that work across the NAO. They have specialist skills and capabilities relevant to all clusters. By providing cross-organisational support, they make sure we target expertise consistently so that all audits and published outputs benefit from the full range of what we know. They also promote knowledge-sharing and allow our staff to develop specialist skills.

Our clusters and their objectives

Our clusters are supported by six networks of experts



Our network of experts – centres of expertise to support our work

- Commercial and contracting
- Corporate finance
- Digital
- Operations and process management
- Project and programme management delivery
- Methods, economics and statistics

People

19 Our people remain our most valuable and important asset. We attract and retain high-quality staff by providing an attractive, empowering workspace, a competitive reward package and support for their continuing development. During 2016-17, we employed an average of 811 full-time equivalent staff. Most of our front-line staff are qualified accountants or in training with the main accountancy institutes. This expertise is supported by other skilled professionals such as economists, statisticians and business analysts, as well as those with commercial and digital skills.

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

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

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

23 Continual staff development is also supported by a programme of staff secondments to both the public and private sectors. This is valuable in increasing insight into how government works, developing operational experience and helping to form useful and practical recommendations for our reports. We are mindful of ethical aspects when agreeing secondments and redeploying staff on their return, to avoid conflicts of interests and to make best use of the skills they have learned.

24 We publish an organisation chart showing our structure and leaderships' responsibilities on our website. At 31 March 2017 the staff distribution by grade and gender for all staff in post (as opposed to full-time equivalent) was as follows:

Staff distribution

Grade	Percentage (%)	Female (%)	Male (%)
Leadership	0	0	100
Director	6	29	71
Manager	16	40	60
Lead	38	46	54
Trainees	25	42	58
Corporate services	14	60	40
Total staff mix	100	45	55

25 We have made progress in the gender diversity at director grade. Four out of five (80%) promotions to director in 2016-17 were of women. The gender diversity of our managers has remained relatively stable over the past three years. Four of the nine (44%) promotions to manager were of women in 2016-17.

26 We conduct an annual survey to understand staff opinions on a range of work-related issues and we benchmark the results against public and private sector norms. Our 2016 survey shows improvements in all areas and results compare favourably with our benchmarks. A total of 88% of respondents say they are interested in their work, 93% of people have a clear understanding of the NAO's purpose and 77% of people say they feel proud when they tell others that they are part of the NAO.

27 We have continued to embed inclusive practices and behaviours into our ways of working, which has been reflected in our improved scores in the 2016 People Survey, with more employees reporting that the NAO respects individual differences and that they are treated fairly at work than in 2014.

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

Financial information

29 Each year, the NAO's external auditor undertakes an annual value-for-money review of a specific aspect of the NAO's business. In 2016-17, this review addressed the NAO's workforce deployment and utilisation. The review concluded that it is clear that the NAO has been on a transformation journey over a number of years. The NAO has focused on aligning its work with the way private sector accounting firms operate, in terms of methodologies and approaches and the systems and processes that support them. However, there are limits to how far the NAO could and should align itself with these methods and approaches. Most of the NAO's work is not fee based, so the commercial drivers of a professional accounting firm do not always apply. The Business Improvement Programme (BIP) is the next significant step in the NAO's transformation and will provide the platform on which the NAO will operate in future.

30 Our full financial information is contained in our Annual Report and Accounts 2016-17, which can be found on our [website](#).

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 provided and received. Details can be found on our [website](#).

National Audit Office operating segments

	2016-17								
	Audit and assurance £000	Value for money £000	Investigations and insight £000	Support to Parliament £000	International relations £000	Comptroller function £000	Voted £000	Non-voted £000	Total £000
Gross expenditure	50,468	16,102	9,912	5,079	1,362	155	83,078	291	83,369
Income from services provided	(16,321)	–	–	(568)	(476)	–	(17,365)	–	(17,365)
Rental income	(1,083)	(345)	(213)	(109)	(29)	(3)	(1,782)	–	(1,782)
Net expenditure	33,064	15,757	9,699	4,402	857	152	63,931	291	64,222

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

We consider the chief operating decision body of the NAO to be the Leadership Team, details of whom can be found on pages 24–26.

The NAO reports expenditure and income under six operating segments, full descriptions of which can be found in the Performance Report within the Annual Report and Accounts. Included in the audit and assurance operating segment is international audit work with a gross expenditure of £1.2 million and income of £1.7 million.

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

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

Rental income cannot be directly attributed to the NAO's operating segments and has been apportioned in line with gross expenditure.

Due to the nature of the NAO's activities, the Leadership Team does not receive assets and liabilities analysed by operating segment and therefore such an analysis is not presented here.

APPENDIX TWO

ASSURANCE AND CONTROL

Financial audit

1 Most of the C&AG's audits are by statutory appointment, so he cannot withdraw or decline them. However, the C&AG can report to Parliament on matters that might otherwise have caused him to withdraw from the engagement. No such instances arose during 2016-17.

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 of Financial Audit Practice and Quality in engagement acceptance matters.

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

Policies and procedures

4 The Director of Financial Audit Practice and Quality issues the Financial Audit Manual, and this is the main reference source for audit policy and guidance. It sets out the requirements of International Standards on Auditing (ISAs) (UK and Ireland) and how we must apply these. The manual is updated regularly, to incorporate any changes to professional standards and internal policy changes, which the Leadership Team agrees.

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

Control framework

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

First stage review

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

Second stage review

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

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

8 The most significant technical issues will be considered by an audit panel. Panels are convened to enable audit teams to consult on specific issues as these arise. The panel will include representatives from the Leadership Team, the Director of Financial Audit Practice and Quality, and senior engagement team members. The panel may also include the Engagement Quality Control Reviewer (EQCR) and any other experienced senior NAO staff the Director considers appropriate.

9 The EQCR is an experienced financial audit director independent from the engagement team, or a panel of such individuals who may be assigned to an engagement. The EQCR's role is primarily to challenge key audit judgements and review evidence supporting the engagement team's conclusions on significant matters. EQCRs are assigned to most audits where a qualification of the audit opinion seems likely or where the audit risk is particularly high.

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

11 The Compliance and Quality Unit also reviews the audit files of a sample of completed audits each year. Their purpose is to assess:

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

Audit licences

12 Individuals supervising, managing or directing a financial audit will usually hold the relevant audit licence. The Director of Financial Audit Practice and Quality usually grants audit licences to all staff who:

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

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

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

Value for money

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

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

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

Control framework

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

- Study and product selection. The C&AG and leadership team select VFM studies after information gathering, proposal development and review, to ensure proposals fit with our objectives and Parliament's needs.
- Approving the study concept. The C&AG examines and approves a study concept, considering the rationale, scope, product type and strategic fit of proposed studies.
- Budget approval. Clusters scrutinise and approve study budgets after the C&AG has agreed the scope.
- Proof-of-concept meeting. When most of the fieldwork has been completed, the C&AG challenges the study team on how the evidence collected supports the logic of the intended report.
- C&AG review. The C&AG reviews the draft provisional audit findings and the draft final report. Once he is content the team sends the draft to the audited body for consideration and comment.
- Copy editor and data presentation review. The copy editor edits the draft report before publication. This is designed to confirm adherence to our publication standards and readability.
- Optional quality assurance. A range of additional quality assurance is available for teams, including reviews of the draft report, methods-specific quality assurance, and external advice or consultancy.
- Post-project review. After we publish the report, the study team reviews the conduct of the study to identify examples of good practice and lessons learned, which they disseminate across the organisation.
- Internal cold review. We review about 12 publications each year, from across the office and from our full range of wider assurance products. We identify (using a standard set of criteria) and examine any risks to quality and/or compliance with the VFM and non-financial audit standards. The work of each VFM director is examined approximately every two years. Eleven outputs published in 2016-17 have been subject to an internal cold review. The reviews highlighted some common issues including: consistency in documenting audit evidence and director review; the need for reports to articulate more clearly their scope, and evaluative criteria used; and compliance with mandatory steps for VFM-like outputs such as investigations.
- External cold review. A sample of published VFM reports (11 in 2016-17) are subject to an independent, external review. The reviewer considers the report against a set of agreed criteria.

Training and technical competence

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

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

Financial audit

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

21 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.

22 As part of their annual CPD requirement, qualified staff must attend an annual assurance update session each year. This covers:

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

23 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 2016-17 targeted training was provided in the following areas:

- the auditing of accounting estimates;
- the auditing of pensions schemes; and
- group audits.

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

Value for money

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

26 Courses for trainees include among others:

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

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

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

External monitoring

External review – financial audit

29 The Audit Quality Review team (AQRT) of the Financial Reporting Council reviews a selection of audit files. In 2016-17, the AQRT reviewed six completed audit files (2015-16: six), of which two (2015-16: two) were performed under the Companies Act 2006. We responded to their findings.

30 The AQRT also carried out a follow-up review of our policies, processes and procedures supporting financial audit quality. The inspection considered the actions taken on findings arising from the 2015-16 inspection.

31 The inspection highlighted areas for further improvement. The issues identified are around insufficient consideration and challenge of management in relation to key assumptions used in valuations and estimates; insufficient appropriate audit evidence obtained for judgemental areas; and weaknesses in testing of controls supporting system generated reports used in obtaining audit evidence.

32 To address these points, we have:

- communicated the AQRT's findings to all staff and incorporated the feedback into our annual assurance training;
- held detailed discussions of AQRT findings with directors and managers in group meetings;
- enhanced our mandatory consultation procedures for our highest-risk audits;
- updated our standard audit documentation templates and guidance including our Financial Audit Manual;
- promoted a more explicit approach to planning for financial audit quality by challenging teams to consider further client delivery risk, critical path management, audit risk and staffing;
- provided mandatory training to all EQCR directors to ensure that they adopt a consistent approach in undertaking and documenting their role;
- re-emphasised the importance of embedding our consideration of risk throughout the audit via office-wide annual technical updates;
- provided additional training for engagement managers and engagement directors where they are adopting that role for the first time; and
- committed to strengthening the capacity of our Central Quality Unit and redesigning the internal review programme.

33 We are continuing to invest in our capability to support IT automated controls based audits by redeploying and training audit staff to undertake IT work. We are investing in our data analytical approaches and capabilities for the financial audit practice by implementing a resourcing plan for delivering increased data analytics in 2017-18.

External review – VFM reports

34 For 23 years we have used external specialists to review VFM reports. In 2016-17, a sample of our reports were reviewed by independent experts from Oxford Business Schools, Risk Solutions and RAND Europe.

35 Our reviewers assess the reports against a set of criteria:

- scope;
- qualitative analysis;
- structure and presentation;
- graphics and statistics;
- appropriateness and use of methods;
- synthesis of VFM conclusions, recommendations, systemic issues; and
- overall perception.

36 They provide a written review assessing how each report performs against the criteria in paragraph 35, including an overall assessment. The reviewers have also reported on specific themes such as the quality of drafting and how we use evidence. The Audit Practice and Quality (APQ) Committee uses these reviews as the basis of discussions on quality.

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

APPENDIX THREE

TRANSPARENCY REPORT DISCLOSURE REQUIREMENTS

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

Provision of the Instrument	How the National Audit Office complies with the Instrument
A description of the legal structure and ownership of the transparency reporting auditor.	See Appendix One: Governance and accountability
Where the transparency reporting auditor belongs to a network, a description of the network and the legal and structural arrangements of the network.	Not applicable to the National Audit Office.
A description of the governance structure of the transparency reporting auditor.	See Appendix One: Governance and accountability
A description of the internal quality control system of the transparency reporting auditor and a statement by the administrative or management body on the effectiveness of its functioning.	See Part Two for the internal quality control system and Appendix One for Board effectiveness
A statement of when the last monitoring of the performance by the transparency reporting auditor of statutory audit functions within the meaning of paragraph 13 of Schedule 10 to the Act (as amended by regulation 23 of the Statutory Auditors and Third Country Auditors Regulations 2007 (S.I. 2007/3494)) took place.	See Part Two, High-quality performance section
A list of public interest entities in respect of which an audit report has been made by the transparency reporting auditor in the financial year of the auditor; and any such list may be made available elsewhere on the website specified in regulation 4 provided that a clear link is established between the transparency report and such a list.	In 2016-17, the NAO audited five public interest entities. However, there were no additional reporting responsibilities in place, as these came into force along with the revised ISAs (UK) and Ethical Standard for the 2017-18 financial year.
A description of the transparency reporting auditor's independence procedures and practices including a confirmation that an internal review of independence practices has been conducted.	See Part Two, Independence section
A statement on the policies and practices of the transparency reporting auditor designed to ensure that persons eligible for appointment as a statutory auditor continue to maintain their theoretical knowledge, professional skills and values at a sufficiently high level.	See Part Two, Our people section
Financial information for the financial year of the transparency reporting auditor to which the report relates, including the showing of the importance of the transparency reporting auditor's statutory audit work.	See Appendix One, Financial information section
Information about the basis for the remuneration of partners.	See Appendix One: Governance and accountability

APPENDIX FOUR

REVIEW OF NAO COMPLIANCE WITH THE AUDIT FIRM GOVERNANCE CODE 2016-17

1 We are not required to comply with the Audit Firm Governance Code, however, in the spirit of adhering to best practice, to the extent that the Code is relevant to the NAO, which is a Supreme Audit Institution, we set out how we comply with the Audit Firm Governance Code. Compliance is required for those firms having 20 or more listed entities as clients.

Throughout the code reference to 'a firm' means 'a firm that audits listed companies in the UK'.

	Provision of the code	How the National Audit Office complies with the code
A – Leadership	<p>A.1: Owner accountability principle – The management of a firm should be accountable to the firm's owners and no individual should have unfettered powers of decision.</p> <p>A.1.1: The firm should establish Board or other governance structures, with matters specifically reserved for their decision, to oversee the activities of the management team.</p> <p>A.1.2: The firm should state in its transparency report how its governance structures and management team operate, their duties and the types of decisions they take.</p> <p>A.1.3: The firm should state in its transparency report the names and job titles of all members of the firm's governance structures and its management team, how they are elected or appointed and their terms, length of service, meeting attendance in the year and relevant biographical details.</p> <p>A.1.4: The firm's governance structures and management team and their members should be subject to formal, rigorous and ongoing performance evaluation and, at regular intervals, members should be subject to re-election or re-selection.</p> <p>A.2: Management principle – A firm should have effective management which has responsibility and clear authority for running the firm.</p> <p>A.2.1: The management team should have terms of reference that include clear authority over the whole firm, including its non-audit businesses and these should be disclosed on the firm's website.</p>	<p>The owner accountability principle does not directly apply to the NAO. The C&AG has statutory powers given by Parliament.</p> <p>All other provisions are covered by Appendix One: Governance and accountability and relevant sections of our Annual Report and Accounts.</p> <p>These provisions are set out in the Budget Responsibility and National Audit Act 2011, which we fully comply with.</p>
B – Values	<p>B.1: Professionalism principle – A firm should perform quality work by exercising judgement and upholding values of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour in a way that properly takes the public interest into consideration.</p> <p>B.1.1: The firm's governance structures and management team should set an appropriate tone at the top through its policies and practices and by publicly committing themselves and the whole firm to quality work, the public interest and professional judgement and values.</p> <p>B.1.2: The firm should have a Code of Conduct which it discloses on its website and requires everyone in the firm to apply.</p> <p>B.2: Governance principle – A firm should publicly commit itself to this Audit Firm Governance Code.</p> <p>B.2.1: The firm should incorporate the principles of this Audit Firm Governance Code into an internal Code of Conduct.</p> <p>B.3: Openness principle – A firm should maintain a culture of openness which encourages people to consult and share problems, knowledge and experience in order to achieve quality work in a way that properly takes the public interest into consideration.</p>	<p>These provisions are covered by our Code of Conduct and NAO Strategy documents, available on our website.</p> <p>The NAO does not need to publicly commit to the Audit Firm Governance Code. We choose to show in our Transparency Report how we comply with the Code's provisions.</p> <p>This provision is addressed through our values and strategy, details of which can be found in our Annual Report and the NAO Strategy document published on our website.</p>

	Provision of the code	How the National Audit Office complies with the code
C – Independent non-executives	<p>C.1: Involvement of independent non-executives principle – A firm should appoint independent non-executives who through their involvement collectively enhance shareholder confidence in the public interest aspects of the firm’s decision-making, stakeholder dialogue and management of reputational risks including those in the firm’s businesses that are not otherwise effectively addressed by regulation.</p> <p>C.1.1: Independent non-executives should: have the majority on a body that oversees public interest matters; and/or be members of other relevant governance structures within the firm. They should also meet as a separate group to discuss matters relating to their remit.</p> <p>C.1.2: The firm should disclose on its website information about the appointment, retirement and resignation of independent non-executives, their duties and the arrangements by which they discharge those duties and the obligations of the firm to support them. The firm should also disclose on its website the terms of reference and composition of any governance structures whose membership includes independent non-executives.</p> <p>C.2: Characteristics of independent non-executives principle – The independent non-executives’ duty of care is to the firm. They should command the respect of the firm’s owners and collectively enhance shareholder confidence by virtue of their independence, number, stature, experience and expertise.</p> <p>C.2.1: The firm should state in its transparency report its criteria for assessing the impact of independent non-executives on the firm’s independence as auditors and their independence from the firm and its owners.</p> <p>C.3: Rights of independent non-executives principle – Independent Non-Executives of a firm should have rights consistent with their role, including a right of access to relevant information and people to the extent permitted by law or regulation, and a right to report a fundamental disagreement regarding the firm to its owners and, where ultimately this cannot be resolved and the independent non-executive resigns, to report this resignation publicly.</p> <p>C.3.1: Each independent non-executive should have a contract for services setting out their rights and duties.</p> <p>C.3.2: The firm should ensure that appropriate indemnity insurance is in place in respect of legal action against any independent non-executive.</p> <p>C.3.3: The firm should provide each independent non-executive with sufficient resources to undertake their duties including having access to independent professional advice at the firm’s expense where an independent non-executive judges such advice necessary to discharge their duties.</p> <p>C.3.4: The firm should establish, and disclose on its website, procedures for dealing with any fundamental disagreement that cannot otherwise be resolved between the independent non-executives and members of the firm’s management team and/or governance structures.</p>	<p>These provisions are set out in the Budget Responsibility and National Audit Act 2011, which we fully comply with.</p> <p>These provisions are set out in the Budget Responsibility and National Audit Act 2011, which we fully comply with.</p> <p>These provisions are set out in the Budget Responsibility and National Audit Act 2011, which we fully comply with.</p> <p>We provide sufficient resources to the independent non-executives to undertake their duties.</p> <p>Indemnification of independent non-executives is covered by the Budget Responsibility and National Audit Act 2011.</p> <p>Included in the Senior Independent Director’s role is their duty to act as a mediator between independent non-executives and management.</p> <p>Our existing arrangements are currently under review.</p>

	Provision of the code	How the National Audit Office complies with the code
D – Operations	<p>D.1: Compliance principle – A firm should comply with professional standards and applicable legal and regulatory requirements.</p> <p>D.1.1: The firm should establish policies and procedures for complying with applicable legal and regulatory requirements and international and national standards on auditing, quality control and ethics, including auditor independence.</p> <p>D.1.2: The firm should establish policies and procedures for individuals signing group audit reports to comply with applicable standards on auditing dealing with group audits, including reliance on other auditors whether from the same network or otherwise.</p> <p>D.1.3: The firm should state in its transparency report how it applies policies and procedures for managing potential and actual conflicts of interest.</p> <p>D.1.4: The firm should take action to address areas of concern identified by audit regulators in relation to the firm’s audit work.</p> <p>D.2: Risk management principle – A firm should maintain a sound system of internal control and risk management over the operations of the firm as a whole to safeguard the owners’ investment and the firm’s assets.</p> <p>D.2.1: The firm should, at least annually, conduct a review of the effectiveness of the firm’s system of internal control. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.</p> <p>D.2.2: The firm should state in its transparency report that it has performed a review of the effectiveness of the system of internal control, summarise the process it has applied and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review. It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in its financial statements or management commentary.</p> <p>D.2.3: In maintaining a sound system of internal control and risk management and in reviewing its effectiveness, the firm should use a recognised framework such as the Turnbull Guidance and disclose in its transparency report the framework it has used.</p> <p>D.3: People management principle – A firm should apply policies and procedures for managing people across the whole firm that support its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code.</p> <p>D.3.1: The firm should disclose on its website how it supports its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code through recruitment, development activities, objective setting, performance evaluation, remuneration, progression, other forms of recognition, representation and involvement.</p> <p>D.3.2: Independent non-executives should be involved in reviewing people management policies and procedures.</p> <p>D.4: Whistle-blowing principle – A firm should establish and apply confidential whistle-blowing policies and procedures across the firm which enable people to report, without fear, concerns about the firm’s commitment to quality work and professional judgement and values in a way that properly takes the public interest into consideration.</p> <p>D.4.1: The firm should report to independent non-executives on issues raised under its whistle-blowing policies and procedures and disclose those policies and procedures on its website.</p>	<p>These provisions are covered in Part Two, Quality control – Independence section.</p> <p>These provisions are covered in Appendix One: Governance and accountability.</p> <p>These provisions are covered in Part Two, Quality control – Our people section, as well as the NAO Strategy document.</p> <p>These provisions are covered in our Code of Conduct.</p> <p>The report on any issues raised under our whistle-blowing policies is a permanent agenda item for the Audit Committee meetings.</p> <p>Arrangements for publication on website are under consideration.</p>

	Provision of the code	How the National Audit Office complies with the code
E – Reporting	<p>E.1: Internal reporting principle – The management team of a firm should ensure that members of its governance structures, including owners and independent non-executives, are supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties.</p> <p>E.2: Financial statements principle – A firm should publish audited financial statements prepared in accordance with a recognised financial reporting framework such as International Financial Reporting Standards or UK GAAP.</p> <p>E.2.1: The firm should explain who is responsible for preparing the financial statements and the firm’s auditors should make a statement about their reporting responsibilities.</p> <p>E.2.2: The firm should report that it is a going concern, with supporting assumptions or qualifications as necessary.</p> <p>E.3: Management commentary principle – The management of a firm should publish on an annual basis a balanced and understandable commentary on the firm’s financial performance, position and prospects.</p> <p>E.3.1: The firm should include in its management commentary its principal risks and uncertainties, identifying those related to litigation, and report how they are managed in a manner consistent with the requirements of the applicable financial reporting framework.</p> <p>E.4: Governance reporting principle – A firm should publicly report how it has applied in practice each of the principles of the Audit Firm Governance Code excluding F.2 on shareholder dialogue and F.3 on informed voting and make a statement on its compliance with the Code’s provisions or give a considered explanation for any non-compliance.</p> <p>E.4.1: The firm should publish on its website an annual transparency report containing the disclosures required by Code Provisions A.1.2, A.1.3, C.2.1, D.1.3, D.2.2 and D.2.3.</p> <p>E.5: Reporting quality principle – A firm should establish formal and transparent arrangements for monitoring the quality of external reporting and for maintaining an appropriate relationship with the firm’s auditors.</p> <p>E.5.1: The firm should establish an Audit Committee and disclose on its website information on the Committee’s membership and terms of reference which should deal clearly with its authority and duties, including its duties in relation to the appointment and independence of the firm’s auditors. On an annual basis, the firm should publish a description of the work of the Committee in discharging its duties.</p>	<p>Our members of the governance structures were supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties.</p> <p>These provisions are covered by our <u>Annual Report and Accounts</u>.</p> <p>These provisions are covered by our <u>Annual Report and Accounts</u>.</p> <p>This Transparency Report provides the disclosures required by this section of the Code and is available on our website.</p> <p>These provisions are covered by our <u>Annual Report and Accounts</u>.</p>

	Provision of the code	How the National Audit Office complies with the code
F – Dialogue	<p>F.1: Firm dialogue principle – A firm should have dialogue with listed company shareholders, as well as listed companies and their audit committees, about matters covered by this Audit Firm Governance Code to enhance mutual communication and understanding and ensure that it keeps in touch with shareholder opinion, issues and concerns.</p> <p>F.1.1: The firm should disclose on its website its policies and procedures, including contact details, for dialogue about matters covered by this Audit Firm Governance Code with listed company shareholders and listed companies. These disclosures should cover the nature and extent of the involvement of independent non-executives in such dialogue.</p> <p>F.2: Shareholder dialogue principle – Shareholders should have dialogue with audit firms to enhance mutual communication and understanding.</p> <p>F.3: Informed voting principle – Shareholders should have dialogue with listed companies on the process of recommending the appointment and re-appointment of auditors and should make considered use of votes in relation to such recommendations.</p>	<p>The NAO conducts regular meetings with senior management and we undertake internal and external dialogue. The other provisions are not applicable to the NAO.</p> <p>Not applicable to auditing firms</p> <p>Not applicable to auditing firms</p>



National Audit Office
