

August 2025

National Audit Office

2024/25 Audit Quality Inspection

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Purpose of the report

This report sets out the principal findings arising from the 2024/25 inspection of the National Audit Office's (the "NAO") audits of 2023/24 financial statements carried out by the Audit Quality Review team ("AQR") of the Financial Reporting Council ("the FRC"). The detailed inspection work was conducted in the period from October 2024 to June 2025 ("the time of our inspection") in accordance with our terms of reference agreed in 2024. Further information on our inspection remit is set out in Appendix 2.

AQR does not select audits for inspection on a statistical basis, so changes from one year to the next cannot, on their own, be relied upon to provide a complete picture of the NAO's performance and are not necessarily indicative of any overall change in audit quality.

Our report focuses on the key areas requiring action by the NAO to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the NAO's audit work. Our findings cover matters arising from our inspection of both individual audits and a review of the NAO's system of quality management which support and promote audit quality.

1. Overview

Scope of our 2024/25 inspection

The NAO has continued to respond positively to and has made good progress on actions to address previous findings. This has resulted in improvements which are reflected across the audit inspections. There remains some work to do to further develop and enhance the NAO's quality management processes to ensure these are sufficiently robust.

The population from which the risk-based sample of audits was chosen varied in complexity, size and risk, with 181 of the 399 audited entities having revenues of between £10 million and £500 million and 47 having revenues in excess of £1 billion.

We examined aspects of seven individual audit engagements, all of which had year-ends dated 31 March 2024. We inspected five Companies Act audits out of 65 audits performed (prior year: five out of 60 audits) and two non-Companies Act audits out of 334 audits performed (prior year: two out of 336 audits)¹. The NAO audits four public interest entities; none of these were inspected in the year.

For the sample of audits inspected, revenue ranged from £186.8 million to £5.7 billion. One entity did not have any income and reported expenditures of £275.8 billion.

In the year to 31 March 2024, there were 107 contracted-out non-Companies Act audits which the NAO excluded from selection. This is where the NAO retains overall responsibility and issues the audit opinion, but contracts with an audit firm to perform the audit. During this period, there were no Companies Act audits performed on a contracted-out basis.

We also undertook a review of the NAO's system of quality management, including a focused review of the aspects of the system that relate to governance and leadership, information and communication, resources, monitoring and remediation, and evaluation.

We will continue to consider and evaluate the adequacy of the number of non-Companies Act audits inspected on a voluntary basis and discuss scoping and sample sizes of all audits with the Comptroller and Auditor General (C&AG).

We currently report privately to the NAO on each audit inspected and on our overall inspection cycle. Historically, the C&AG has sought and obtained the FRC's permission to publish our overall report on the NAO's website, and we are amenable to continuing with this approach. In respect of our statutory work on Companies Act audit inspections, we also report to the FRC Board (in its capacity as the Independent Supervisor).

Summary of inspection findings

From the AQR inspections performed, audit quality in this cycle has significantly improved compared to the prior year, and, for the first time for several years, we have seen consistency in audit quality. Whilst the improvement in quality results is very encouraging, the small sample size means that this may not be representative across the whole of the NAO's audit portfolio. The NAO should continue to focus on delivery of its Quality First plan (introduced in April 2024 and refreshed in April 2025) to help ensure this level of quality is sustained.

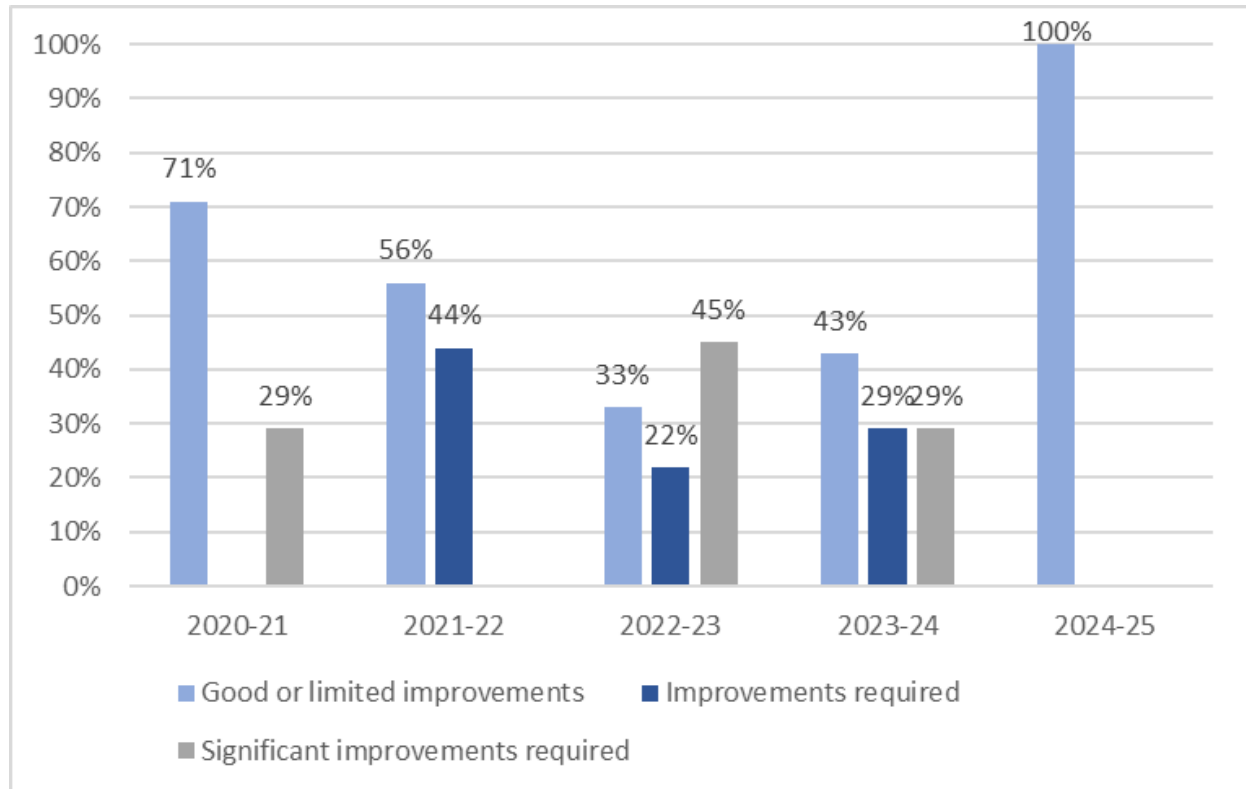
We assessed all seven audits inspected as requiring no more than limited improvements, an improvement from 43% in the previous year and 33% in 2022/23. These results are comparable to

¹The NAO performed:

- 396 audits as of 31 March 2023, comprising 336 non-Companies Act audits and 60 Companies Act audits; and
- 406 audits as of 31 March 2022, comprising 336 non-Companies Act audits and 70 Companies Act audits.

the average quality of the Tier 1 audit firms, where, in 2024/25, 86% of audits inspected required no more than limited improvements. Details of findings are outlined on page 11.

*Our assessment of the quality of audits inspected**



* The table includes results of both Companies Act and non-Companies Act Audits inspected. An audit is assessed as good or limited improvements required where we identified either no or only limited concerns to report. Improvements required indicate that more substantive improvements were needed in relation to one or more issues. Significant improvements required indicate we had significant concerns, typically in relation to breaches of the Revised Ethical Standard 2019, the sufficiency or quality of audit evidence or the appropriateness of key audit judgements.

The table refers to the FRC inspection year, rather than the financial year being audited (for example, the 2024/25 column refers to the NAO's audits of 2023/24 financial statements).

Changes to the proportion of audits falling within each category can reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. For these reasons, and given the sample sizes involved, our inspection findings may not be representative of audit quality across the NAO's entire audit portfolio; nor do small year-on-year changes in results necessarily indicate any overall change in audit quality at the NAO.

Inspection findings

Although all audits inspected required no more than limited improvements, we still had some other findings relating to the need to:

- Improve the application of professional scepticism; and
- Improve the execution of cut off testing.

Over the last two inspection cycles we have seen an improvement in audit quality following several years in which it declined. In recent years the NAO has rolled out its Audit Transformation

Programme, enhanced its audit methodology, developed centres of excellence, introduced new template workpapers, and introduced new audit software, which was deployed on the audits inspected this year. The impact of these initiatives is now being seen in enhanced audit quality and the much improved inspection results this year bear out the significant investment made by the NAO.

In the three inspection cycles covering the period 2020 to 2023, we identified an unacceptable trend of poorer audit quality relating to financial services and audits of financial services-related balances. Whilst we saw evidence of some improvement in the audits inspected in the 2023/24 cycle, we noted that the NAO needed to consider whether it had the necessary skills and expertise in this area given the complexities of auditing valuation models (such as those frequently used in the determination of provisions and fair value estimates in these types of entities) and whether any further changes were required.

In the current inspection cycle, we inspected four entities in the financial services sector or with financial services-related balances. All audits were assessed as requiring no more than limited improvements. We identified several examples of good practice in the audit of these entities, as explained below.

In previous inspection cycles, we have also had recurrent findings relating to the testing of journal entries to respond to the risk of fraud and management override of controls. This year we inspected journal testing on four audits, with each audit being assessed as requiring no more than limited improvements. We also identified examples of good practice in this area, as noted below.

It is clear from the FRC's regular meetings that the NAO has prioritised audit quality and the continued roll out of its new tools to support this, which ensures audit teams have the necessary skills and tools to deliver quality audits. We have seen positive actions where the NAO has taken steps to address the findings in our previous reports, including ensuring that the team responsible for a new complex audit received appropriate training, the roll out of new audit software, enhancements to the hot and cold review programmes, and further development of the centres of expertise.

All of these actions should position the NAO well to be able to demonstrate a sustained level of audit quality, but focus will continue to be required to maintain the high standards achieved.

Good practice

We identified examples of good practice in the audits we reviewed, including the following:

Good practice observations
<p>Planning</p> <p>On one audit of a highly specialised financial services entity, which the NAO was auditing for the first time, it identified the need for additional technical expertise, sourced appropriate training for the audit team and appointed an auditor's expert to assist with the audit. The effectiveness of this approach was evident in the audit file, which demonstrated the audit team's good understanding of the entity and its business environment.</p> <p>On another audit the audit team's proactive detailed consultation with the NAO's central team resulted in enhancements to the audit procedures used to evaluate guarantees and assess their valuation.</p> <p>Execution</p> <p>On an audit with highly complex valuations and significant management judgements, there was robust challenge by the audit team including a thorough consideration of the relevant accounting</p>

standards. In response to challenge from the Engagement Quality Reviewer, the audit team carefully evaluated the information received from both its own expert and management's expert in line with relevant auditing standards. This led to reporting to the Audit Committee that was comprehensive and transparent. On the same audit, in addition to the standard NAO audit procedures, the audit team performed further bespoke analysis of the journal population, identifying a subset of entries with high-risk characteristics that were specifically tested.

On another audit, the audit team's testing of the design and implementation of controls over journals demonstrated that the interface journals could not be manipulated, justifying the testing focusing on manual journals. The audit team developed a matrix approach to articulate the rationale for the risk criteria and the risk factor combinations used in this testing.

On the same audit, there was effective use of NAO modelling specialists to review and challenge the audit team's work on guarantees, which management had valued using spreadsheet models.

Review of the NAO's system of quality management ("SoQM")

We inspected the firm under the International Standard on Quality Management (UK) 1 (ISQM 1). The standard, which was first effective in the 2023/24 inspection cycle requires a significantly different approach to the management of risks to audit quality compared to the standard which previously applied (ISQC 1). The NAO has made significant progress in addressing the matters we raised in our previous report but acknowledges that there are further improvements to be made and has plans to achieve these.

Our inspection focused on the following areas:

- Monitoring and remediation;
- Annual evaluation;
- Governance and leadership;
- Information and communication; and
- Resources, including service providers.

The C&AG concluded that the NAO's SoQM, except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation and operation of the system of quality management, provided reasonable assurance that the objectives of the SoQM were being achieved.

Our inspection identified a number of weaknesses in different aspects of the NAO's SoQM. These have been reported to the NAO, and an action plan agreed.

Our findings in these areas related principally to aspects of:

- Risks to quality objectives - identification, granularity, completeness, and assessment;
- The design and implementation of responses to address risks;
- Monitoring how effectively risks are mitigated;
- Monitoring of contracted out audits; and
- The use of technology in the SoQM.

Further details of our findings are given in section 3, together with the NAO's agreed actions.

Good practice

We identified examples of good practice in our review, including:

- Cold file review documentation clearly evidencing how an audit had addressed a complex area; and
- Detailed and extensive ongoing testing to support the new audit software.

This year the FRC, in its role as an improvement regulator, has begun to provide additional support to the NAO with the allocation of a supervisor to work alongside the NAO to assess the effectiveness of the NAO's audit quality initiatives, including reviewing the formulation and progress on action plans, root cause analysis and quality improvement plans.

NAO's overall response

We welcome the findings of the FRC review. We are pleased that the inspections show that we have made a big step forward in the quality of our audits. These results show the positive impact of the investments we have made, over several years, in our methodology, the development and implementation of our new Apex system and the on-going implementation of Quality First Plan. This improvement is evident not only in the overall ratings but also in the reduction in the number of findings and the increase in examples of best practice.

The FRC's findings are reinforced by our own internal indicators, which show improved people engagement and stronger audit quality culture scores. Feedback from audited bodies also continues to show high levels of confidence in our work.

At the same time, we are not complacent. We recognise that there is more for us to do to ensure that we consistently meet the high-quality standards expected of us by our stakeholders year on year. Our internal quality reviews show a more modest improvement, with 71% of inspected audits found to meet quality standards, and point to areas where we need to maintain our focus. Alongside this, the findings of our own evaluation and the FRC's review show that we need to make further improvements to our System of Quality Management (SoQM).

Audit Quality is a central to our new 5-year strategy, published in April 2025. Aligned to our new strategy, in 2025 we have also refreshed our Quality First Plan, first established in 2024, to set out a clear programme of action under six pillars, designed to embed and sustain high-quality audit:

- We are increasing our focus on people through fostering our quality culture, enhancing capacity and building on the improvements we have already made to provide excellent learning and development.
- We are capitalising on the benefits of our new methodology and Apex as well as leveraging new technologies, including AI; and extending our use of data and controls-led approaches, to boost quality, productivity and efficiency. To support this, we are developing our data analytics and digital competencies to meet the growing demands of our audit responsibilities.
- We are making continuous improvements to our audit methodology and support, responding to user feedback and benchmarking our work against Tier One firms.
- We are improving our project management, building our capability and expertise in specialist areas and tailoring our audit approaches to better address risks.

- We are continuing to strengthen our SoQM, including our monitoring arrangements, with a focused action plan to address findings coming out of the current FRC inspection round where we recognise there is more work to do.
- We are engaging with external stakeholders (HMT, standard setters and audited bodies) to ensure that we are working in an environment that is conducive to high-quality audit that is valued by stakeholders.

We are pleased with the progress we are making and grateful for the hard work of our teams. We welcome the feedback from the FRC and will use these insights to continue to improve, as we work towards our goal of ensuring that our audits are consistently high-quality, delivered with pride and trusted by our stakeholders.

Engagement with Audit Committees

For the first time this year, and following our request to the NAO, we have engaged with Audit Committee chairs for each of the entities whose audits we have inspected. Discussions with Audit Committee chairs help us to have a better understanding of the interaction between the Audit Committee and auditors, and help us to plan the scope of our work. We have also provided a copy of our individual inspection reports to them. This has aligned our inspection approach with the one we use at the major audit firms.

The NAO has also continued its programme of discussions and conferences with the Audit Committee chairs of the bodies it audits to promote audit quality.

The Public Accounts Commission

The NAO continues to take forward its on-going commitment to transparency and accountability. A key development in recent years has been to work with the Public Accounts Commission (“the Commission”), on behalf of Parliament, so that the Commission is able to scrutinise effectively the quality of the NAO’s financial audit work. The Government announced in the 2024 King’s Speech that it will bring forward a bill on audit reform and corporate governance which may update the accountability arrangements for the NAO’s audit quality, including the role of the Commission, through legislation.

Controls based audits

We note that, currently, the NAO adopts only limited controls (including IT controls) testing where they rely upon the design, implementation and operating effectiveness of management internal controls. In 2024/25, only 19 audits (6.2% of all audits that are not contracted out to Firms) tested the operating effectiveness of internal controls, including four large Government departments. Controls testing is typically applied to the largest and most complex audits in the NAO’s portfolio. We note that the proportion of audits testing controls is lower than found at major audit firms (approximately 10%), reflecting the age of the systems in place and maturity of financial management within the NAO’s audited bodies. We encourage the NAO to continue to seek opportunities with its audited bodies to increase the number of audits that test controls, particularly on the largest entities subject to audit, providing some assurance and reliance on the internal controls environment.

NAO's internal quality monitoring results

We have previously raised concerns over delays in the NAO's Internal Quality Monitoring (IQM) process. The IQM process consists of a sample of completed audit files being selected each year by the NAO for a retrospective internal audit quality inspection. This year there has been further improvement in the timeliness with which the IQM inspections were completed, as all inspections of 31 March 2024 audits were completed by 31 March 2025, allowing remedial actions in response to their findings to be implemented in audits for the 31 March 2025 year-end.

Overall, the NAO's monitoring found that of the 24 audits assessed, seven (29%) were found to require improvements/significant improvements, while 17 (71%) were judged to be good or requiring only limited improvements.

2. Review of individual audits

We set out below the key areas where we believe improvements are required to enhance the NAO's audit quality. Findings include those on individual audits assessed as requiring limited improvements if they are considered important due to the extent of occurrence across the audits we inspected.

We asked the NAO to provide a response setting out the actions it has taken or will be taking in each of these areas.

Improve the application of professional scepticism

On four of the audits inspected we found there were several instances which indicated that professional scepticism had not been consistently applied throughout the audit. These were:

- Not sufficiently evaluating the reliability of information, particularly when drawn from entity systems;
- Not corroborating management explanations in an area of significant risk; and
- Insufficient challenge of management and their experts.

Professional scepticism is a critical attribute of an auditor's mindset when undertaking an audit. The most significant quality issues identified by the FRC over a number of years involve the inconsistent application of professional scepticism and challenge, resulting in the poor application of professional judgement.

NAO Actions

We welcome the recognition by the FRC of good practice examples from our work which implicitly include the effective exercise of professional scepticism. We also recognise that consistent exercise of professional scepticism is critical to our role and in delivering high-quality audits.

Our Quality First Plan in 2024, now refreshed in 2025, highlights learning and culture as one of our six pillars of quality

In response to the emerging findings from the FRC inspections, and from our own internal inspections, we delivered Spring Accelerator training in early 2025 which included:

- Quality finding sessions for all qualified auditors which emphasised the importance of professional judgement and used the FRC Professional Judgement Framework to illustrate the necessary factors, including professional scepticism, for delivering high-quality audits every time.
- Director Masterclasses on how to avoid bias in the exercise professional judgement.

We will continue to use the Professional Judgement Framework to inform our root cause analysis and training.

Since 2024, we have in place a culture quality survey that measures the views of NAO staff alongside other quality measures provided by inspection and feedback from audited bodies. The survey includes questions on the exercise of professional scepticism (score = 8.4 out of 10 at January 2025) and demonstrates the importance our people place on it. We will continue to monitor our quality culture and take appropriate action through our learning and culture workstream.

Improve the execution of cut-off testing

On two of the audits inspected we found insufficient testing of revenue cut-off to assess whether revenue had been recorded in the correct period, and the presumed fraud risk appropriately addressed. In both instances, we found that there had been insufficient testing of revenue recorded in the period immediately before the year-end.

NAO's actions

In response to the FRC finding, we have revised our cut-off testing procedures for 2024-25 audits.

We have added an additional requirement in Apex, our audit software platform, that teams must complete where they have a significant risk over cut-off. Audit teams are now required to document the data source used for cut-off testing and whether it is appropriate to address the identified risk.

3. Review of the NAO's SoQM

Under International Standard on Quality Management (UK) 1 (ISQM 1) an audit firm is required to identify its quality objectives, the risks to these quality objectives, develop responses to mitigate these risks, monitor the operation of the responses, and evaluate the overall System of Quality Management (SoQM) annually. We reviewed the NAO's design, implementation, and operation of its SoQM, focusing on the components of governance and leadership, information and communication and resources. We also reviewed the process, evidence, and outcome for the annual evaluation of the NAO's SoQM. This included how other sources of information on audit quality were considered, and how matters were aggregated. We did not independently perform, or reperform, the NAO's overall annual evaluation.

As ISQM 1 is focused on how firms achieve iterative improvement, we considered how the NAO is developing its SoQM, including its response to the action plan agreed in the prior year and the findings we shared during this year's inspection period. We found that there had been significant progress made in addressing the findings in our previous report but, as acknowledged by the NAO, itself, there remain some important matters to resolve. Our inspection findings in this area are reflective of our forward-looking approach as we seek to support firms in their development of effective, proportionate SoQMs.

Risks - identification, granularity, completeness, and assessment

Background

Risks were not consistently identified at a sufficiently granular level and we noted that some expected risk elements were not identified, which made it harder to identify appropriate mitigating responses. There were also instances where risks that appeared relevant to the NAO had not been recognised as risks and it was not clear the rationale for concluding that these risks were not probable. It also was not clear how the assessment of post-mitigation risk ratings was supported by, and responsive to, the assessment of the design, implementation and operation of responses.

Finding

The NAO must ensure that risks are identified on a consistently granular basis to enable mitigating responses to be identified and assessed. The NAO should review its risks to reconsider if these are complete, ensuring that it robustly assesses which risks meet the threshold for recognition. The assessment of post-mitigation risk ratings should be supported by robust assessment of responses and iteratively updated where deficiencies are identified.

NAO's actions

Since our last inspection, we have revisited the component risk registers to capture risks on a more granular basis, including those risks at the lower end of the risk spectrum. As part of that exercise, we reviewed available external resources, including from IFAC to inform the completeness of our risk assessment. We now recognise over 200 risks across the six ISQM components.

We acknowledge, as identified by the FRC, that there remains some inconsistency in the granularity and completeness of the risks identified across the six components. In response we will:

- Make changes to identified risks by responding to specific feedback from the AQR inspection of individual components;
- Review the completeness and consistency of our component registers as part of our cyclical risk reviews;

- Ensure that all quality objectives have at least one identified risk; and
- Continue to reassess our risk assessment in the light of deficiencies identified.

The design and implementation of responses to address risks

Background

The NAO's identification of responses, and assessment of their design and implementation, was too high-level and did not adequately set out how the responses were able to consistently mitigate all related risks. In some instances, the responses were overarching policies or expectations or the existence of templates and guidance. Some long-established operational practices were not identified as responses, and it was not clear that all key responses were identified.

Finding

The NAO should identify responses that drive consistent and robust mitigation of its risks, and ensure that responses are sufficiently granular, including a mix of preventative and detective responses, to reduce quality risks to an acceptable level. The NAO needs to ensure that the design assessments robustly evidence how each risk is mitigated by the mapped responses, either individually or in aggregate. The NAO should evidence descriptions of responses that are sufficiently detailed to demonstrate this. We expect this to include information on who performs the response, information used, thresholds or criteria for identifying exceptions and the process for following up exceptions.

NAO's actions

We recognised in the C&AG's Annual Evaluation of the System of Quality Management for 2024 that the key deficiency requiring further work, and which we were unable to complete in response to the FRC feedback in 2024, was to document, assess and evidence the design and implementation of responses within the System of Quality Management at the level of each individual control.

We have reviewed our approach to documenting our processes and controls in response to the latest FRC feedback and developed a plan which focuses on capturing all of the, often long established, key operational processes within the SoQM and the key controls within them.

By September 2025, we will:

- Revisit all responses, refreshing where needed, and differentiate between policies, procedure and key controls;
- Document the established end-to-end operational processes, how they address the related risks, and the key controls within them; and
- Complete our performance and documentation of our D&I assessment of identified key controls.

In doing so we will ensure that we evidence how the controls mitigate the risks, including making adjustments to our established processes where necessary.

Monitoring the effectiveness of processes to mitigate risks to quality

Background

ISQM1 requires organisations to design and perform monitoring activities to provide relevant, reliable and timely information on the design, implementation and operation of the SoQM. If deficiencies are identified, management should take timely, appropriate action to remedy these.

The NAO undertook a series of monitoring activities during the year, introducing some additional activities compared to the previous year. These new activities included the testing of 13 groups of controls. Out of 219 controls identified, 108 were tested using this approach, with testing of five controls continuing after the date of the annual evaluation of the SoQM. Samples sizes per group ranged from 5-10 and not all controls within each group were tested as the sample was spread between the controls. The NAO did not perform design assessments to demonstrate that all controls within each group were homogeneous. Furthermore, it was not clear how the NAO assessed which responses were impacted by control findings, to identify the impact at an individual risk level.

Additionally, as the NAO's responses were not sufficiently granular, we noted instances where it was not clear how the monitoring activities tested the operating effectiveness of responses. There was a lack of evidence as to how the monitoring procedures performed ensured that responses operated effectively and consistently, including how thresholds and follow up procedures were applied.

The NAO relied on the results of cold file reviews to assess the operation of some responses. However, there was no evidence that these reviews specifically considered the operation of SoQM responses that the NAO relied on in the reviews to test.

Although the NAO identified SoQM deficiencies, it did not perform root cause analysis to support the assessment of their severity and pervasiveness. The NAO concluded that the deficiencies were not pervasive, individually or in aggregate, but the basis for this was unclear.

The NAO started designing remediating actions in early 2025. It was not clear how the effectiveness of these actions were assessed.

Findings

The NAO should ensure that, where controls testing is used for monitoring, it is clear how this control testing addresses the mitigation of risks and that a sufficient sample is tested for each key control to provide assurance over the operation of that control, with sample sizes determined using a risk-based approach. Where controls are tested as a group, the NAO must assess and evidence the homogeneity of the group. Monitoring procedures need to provide evidence that the key elements of the responses are operating effectively as expected, to achieve the desired risk mitigation. The NAO should consider what would constitute an exception for each response and apply these thresholds consistently.

Where monitoring identifies that responses do not operate as expected, the NAO should reassess if the response is designed effectively.

Where the NAO relies on hot and cold file reviews to test the operation of SoQM responses, there needs to be clear evidence of how these reviews monitored these responses.

Monitoring activities and root cause analysis should be sufficiently timely to enable the prompt identification and assessment of deficiencies, prior to completion of the annual evaluation of the SoQM. The NAO must perform and evidence robust assessment of all SoQM deficiencies, individually and in aggregate, to support its conclusions on their severity and pervasiveness.

The NAO should also ensure that remediating actions, for SoQM deficiencies, are designed and implemented on a sufficiently timely basis and that the effectiveness of these actions is assessed.

NAO's actions

We set out above the actions we are taking to revise our approach to documenting and assessing the key controls within the SoQM focusing on the end-to-end operational processes. We are developing a formal monitoring plan which will set out the assurances we need to inform the C&AG's evaluation and the sources of these assurances. This will include specifying the controls to be tested through Hot and Cold Reviews. Our monitoring team will work in parallel to assess the effectiveness of the controls identified, revisiting our approach to testing controls with the enhanced clarity brought through the design and implementation work. We will adopt controls-based testing where appropriate so as to provide the NAO with sufficient evidence from which to draw our conclusions.

Our timetables for this year's monitoring activity will reflect the progress we are making in the design and implementation of controls. We are committed to continuing to bring forwards our monitoring, inspection and RCA work. This work will inform the C&AG's evaluation, for which we will revisit the approach to assessing the identified deficiencies in response to the FRC's feedback.

As we turn to 2026, we will have a much firmer base to take forward an annual programme of activity, using this year's assessment as a base to bring us fully into line with the expectation of the standard.

Monitoring of contracted out audits

Background

The NAO contracts out approximately 20% of its audit portfolio, including the audits of complex entities (requiring specialist knowledge) and non-complex entities, to external audit firms. Where an audit is contracted out, the audit opinion is signed by the Comptroller & Auditor General, but the audit work is undertaken by staff from the external audit firm. An NAO engagement director and manager are appointed to the audit and attend key meetings and review the audit workpapers.

Contracted out audits were also subject to review by the NAO's cold review team. Three cold reviews were undertaken during the year; two of which did not meet the required quality standard. It was unclear how the NAO assessed the causal factors for why the quality issues were not identified prior to signing the audit opinion, and it was not clear how these issues were considered when assessing the reliability of the relevant audit firms as service providers.

The NAO also reviewed the FRC public reports on the audit firms. However, not all firms undertaking contracted out audits are in-scope for review by the FRC nor is the audit entity population covered by these reports (private sector public interest entities), comparable to the population of contracted out audits (public sector non-public interest entities). It was not clear how the NAO was satisfied that it undertook sufficient, additional monitoring at the firm that was not reviewed by the FRC. The NAO does not currently allow the FRC to include contracted out audits as part of its annual review cycle.

Findings

The NAO must improve its monitoring activities of firms undertaking contracted out audits to assess, on a timely basis, the quality of the work performed by these contractors, and to understand and remediate any quality issues arising. It should ensure that its monitoring provides sufficient coverage of all firms undertaking contracted out audits, based on the nature and role of each external firm, and the audits each undertakes.

The NAO should also understand and assess the internal quality processes at the external firm, including the scope and extent of any cold reviews they conduct on contracted out audits, and receive sufficient reporting from these firms to support assessment of these firms.

NAO's actions

The NAO will strengthen its monitoring of work performed by external audit firms. In addition to continuing with the approach of appointing an NAO Director as Engagement Director under ISA 220, responsible for audit direction, supervision, and review, and our contract-monitoring and cold review processes, we will introduce the following enhancements:

- **Quality Management Reporting:** Contracted audit providers will be requested to report relevant issues from their system of quality management. This will become a contractual requirement as existing agreements are renewed in 2026.
- **Cold Review Transparency:** Currently, NAO audits may not be selected annually for cold review by the firms' quality review functions. NAO audits are included in the wider population for selection for cold review but may not be selected annually based on the criteria applied by the relevant firm. We will require providers to report each NAO engagement subject to cold review, supplementing our existing approach of discussions in contract management meetings and with the Engagement Director. From 2026, as contracts are renewed, the NAO will include an expectation that the firms undertake annual cold reviews for NAO audits, in addition to our existing approach of contracted-out audits being included in the NAO's own cold review process.
- **Quality Risk Assessment:** We already consider various sources to assess quality risk, including FRC inspections and Transparency Reports for Tier 1 firms. We will explore additional information to further strengthen this assessment, including, where available, internal reporting of firms.
- **Cold Review:** We will continue the policy implemented in 2024 of selecting at least one audit from each firm as part of our internal cold review inspections.

Our existing measures exceed the quality review standards typically applied to directly delivered audits both at the NAO and at audit firms. Reflecting this, in 2023 the NAO Board approved a strategy to gradually expand in-house audit capacity and reduce full outsourcing. External firms will continue to be used for complex or specialist audits—such as insurance-related entities, pension schemes, and other niche areas—where maintaining in-house expertise is not cost-effective.

The use of technology in the SoQM

Background

In its Annual Evaluation the NAO stated that its SoQM was not managed using individual technological resources. However, we identified several IT applications that were relied on to enable responses to mitigate risks. Whilst the NAO had monitoring processes for each of these applications, were not identified as part of the SoQM or considered when assessing the SoQM's effectiveness.

Finding

The NAO must identify all relevant IT applications and automated controls which are relied on in its SoQM and obtain and evidence appropriate assurance over their reliability. IT General Control testing should inform its assessment of the reliability of IT applications.

NAO's actions

Technology is playing an increasing role in the delivery of audit, and within our SoQM. In 2023-24 we implemented a new audit software platform, Apex, which is now the key IT system for the delivery of audit engagements and within our SoQM.

The FRC have noted in this report the good practice they found in the detailed and extensive ongoing testing to support the new system. However, we acknowledge that we need to do more to document our consideration of the use of technology within our SoQM.

In 2025, as part of the work to document the design and implementation of responses to identified risks, we will identify and document our assessment of IT systems used in the SoQM, including for IT dependent controls.

Approach to reviewing the NAO's quality management

We undertake a rotational approach for inspection under ISQM 1 (previously ISQC 1) with some components reviewed annually and others on a three-year rotational basis. The table below sets out the areas of focus for this year and the previous two years:

Current year (2024/25) ISQM 1	Prior year (2023/24) ISQM 1	Two years ago (2022/23) ISQC 1
<ul style="list-style-type: none">• Annual Evaluation• Monitoring and Remediation• Governance and leadership• Information and Communication• Resources	<ul style="list-style-type: none">• Design and implementation• Annual Evaluation• Monitoring and Remediation• Acceptance and Continuation	<ul style="list-style-type: none">• Engagement director and staff matters• Acceptance and Continuation• Ethics and Independence• Tone at the Top

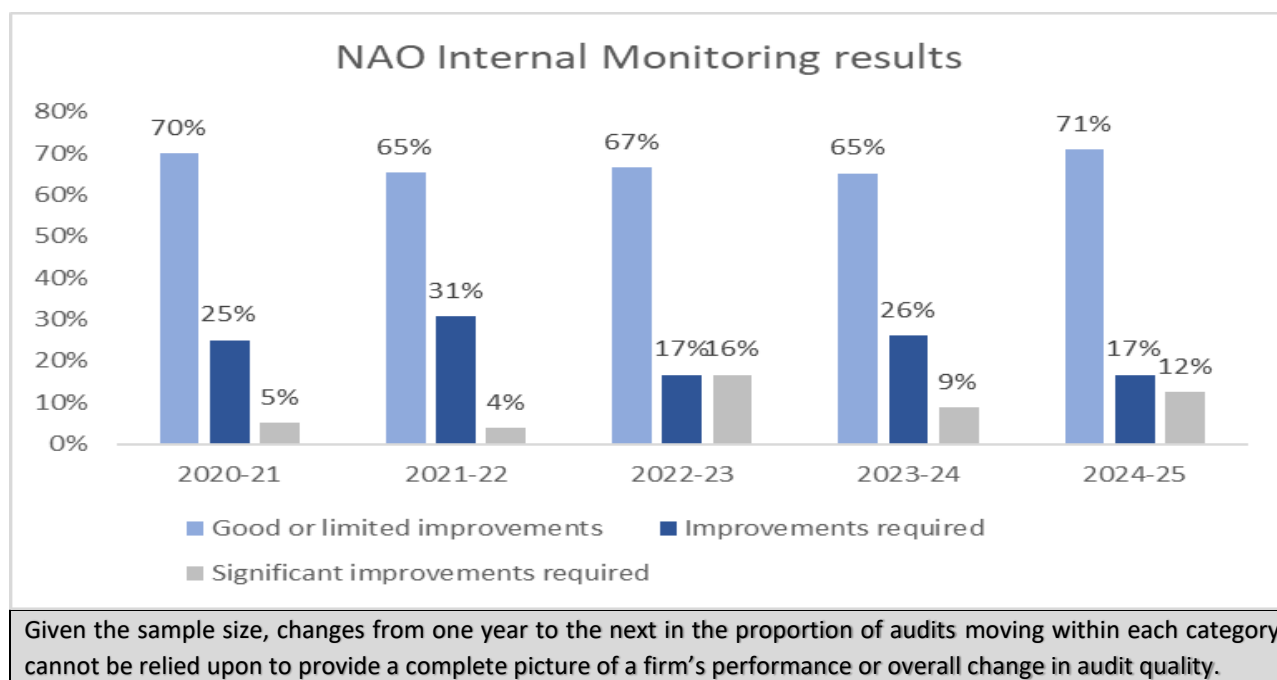
Appendix 1: NAO's internal quality monitoring results

This appendix sets out information relating to the NAO's internal quality monitoring for individual audit engagements. It should be read in conjunction with the NAO's Transparency Report, published in July 2025, which provides further detail of the NAO's internal quality monitoring approach and results and its wider system of quality control. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified the accuracy or appropriateness of these results. In 2024/25, the NAO inspected 24 of its 2023/24 audits, which represented 6% of all audits undertaken. The number of inspections carried out in the previous three years ranged between 20 and 26, representing a similar proportion of all audits undertaken in each year.

Due to differences in how inspections are performed and rated, the results of the NAO's internal quality monitoring may differ from those of external regulatory inspections and should not be treated as being directly comparable to the results of other firms.

Results of internal quality monitoring

The NAO's internal quality monitoring cycle concluded in March 2025. The results of this programme and comparisons to previous years, are set out below, where there has also been an improvement in observed audit quality in 2024/25 compared to the previous year.



* The graph above includes minor rounding. The grading categories used in the graph above are as follows:

1 – Good	The review found that the audit was consistent with the standards and principles of the ISAs and the NAO Financial Audit Manual ("FAM").
2 - Limited improvements required	The review identified only limited improvements were needed to the audit approach.
3 - Areas for improvement	The review identified that more substantive improvements were needed to the audit approach in one or more areas.
4 - Significant areas for improvement	The review identified significant concerns in relation to the sufficiency or quality of audit evidence, the appropriateness of key judgements or other areas of significant non-compliance with the ISAs or the FAM. These concerns may indicate there is a risk the audit opinion is not appropriate.

NAO's approach to internal quality monitoring

A sample of audits is selected from the NAO's audit population considering a number of criteria. The cold review programme aims to cover each financial audit Engagement Director each year, subject to consideration of individuals being subject to an AQR review for that cycle. The cold review programme also aims to include every Senior Audit Manager every three years and Senior Audit Managers new to the grade in their first year. Follow up reviews are performed on audits that fell below the required standard in the previous year.

The NAO performs Root Cause Analysis (RCA) for all audits reviewed by the AQR and its internal quality monitoring that do not meet the required standard. It has also performed analysis with teams where their audits were assessed as meeting quality expectations to understand how good practice could be promoted more widely.

Appendix 2: Information on inspection remit

We inspect the NAO and report our findings annually and privately to the Comptroller and Auditor General (C&AG), as head of the NAO, and also to the Independent Supervisor in its monitoring role in respect of Companies Act audits. Historically, the C&AG has sought and obtained the FRC's consent to publish the report on the NAO's website, and we are supportive of this public transparency and will continue to provide permission for publication whenever permission is sought.

The C&AG audits, under statute, the financial statements of all central government departments, agencies and other public bodies and reports the results of these audits to Parliament. The C&AG is required to form an opinion as to whether the financial statements of audited bodies are free from material misstatement and comply with the relevant reporting requirements and also to provide a regularity opinion. The regularity opinion confirms whether, in all material respects, the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament.

The C&AG also performs audits of the financial statements of certain government-owned companies, incorporated under the Companies Act, which perform a public function for which the C&AG is authorised to conduct audit work by the FRC (in its role as Independent Supervisor). Responsible Individuals within the NAO form an opinion, on behalf of the C&AG, on whether the company's financial statements are free from material misstatement and comply with the relevant reporting requirements.

Our inspection included reviewing the performance of the NAO's:

- Companies Act audit work on behalf of the Independent Supervisor (a statutory responsibility);
- Audit work supporting opinions on the financial statements of non-Companies Act audits (which the FRC carries out on a contractual basis). The number of non-Companies Act audits we inspect is determined by the NAO; and
- Design, implementation, operation and evaluation of its SoQM under the International Standard on Quality Management (UK) 1 (ISQM 1).

We do not inspect non-Companies Act audits which the NAO has contracted out to external audit firms, or the audit work undertaken to assess an entity's compliance with the income and expenditure rules set for it by Parliament.

As part of our usual process, we consider whether action under the FRC's enforcement procedures is appropriate for inspections, as follows:

Companies Act audits

- If an NAO audit is assessed as requiring more than limited improvements, the FRC can consider whether action should be taken under the Auditor General Disciplinary Rules 2012 or the Audit Enforcement Procedure.

Non-Companies Act audits

- The FRC monitors the audit quality of non-Companies Act audits performed by the NAO, by arrangement. Those arrangements are limited to providing audit quality monitoring and do not extend to providing enforcement or disciplinary measures. However, we would write to the C&AG if we identify deficiencies in audit quality which would have led to disciplinary action if similar deficiencies had been identified in an audit undertaken by an audit firm regulated by the FRC.