July 2026

National Audit Office

2025/26 Audit Quality Inspection

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Purpose of the report

This report sets out the principal findings arising from the 2025/26 inspection of the National Audit Office's (the "NAO") audits of 2024/25 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 September 2025 to May 2026 ("the time of our inspection") in accordance with our terms of reference agreed in 2025. 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 2025/26 inspection

The NAO has continued to respond positively to and has made good progress on actions to address previous findings on its System of Quality Management (SoQM). There remains some work to do to further develop and enhance the NAO's quality management processes to ensure these are sufficiently robust. There was one audit inspected which required improvement, resulting in 86% of audits assessed as requiring no more than limited improvements, as opposed to 100% last year.

The population from which the risk-based sample of audits was chosen varied in complexity, size and risk, with 175 of the 397 audited entities having revenues of between £10 million and £500 million and 48 having revenues in excess of £1 billion.

We examined aspects of seven individual audit engagements, all of which had year-ends dated 31 March 2025. We inspected five Companies Act audits out of 65 audits performed (prior year: five out of 65 audits) and two non-Companies Act audits out of 332 audits performed (prior year: two out of 334 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 £0.9 million to £7.3 billion.

In the year to 31 March 2025, there were 100 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 SoQM, including a focused review of the aspects of the system that relate to governance and leadership, relevant ethical requirements, technological resources, monitoring and remediation, and annual 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 its SoQM, each audit inspected and other supervisory activities. 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 remained high and generally consistent with the prior year, although there was one audit which fell below the required standard (prior year: none). Whilst the quality result 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 to help ensure a high level of audit quality is sustained.

We assessed six of seven audits inspected (86%) as requiring no more than limited improvements, a decrease from 100% in the previous year but significantly higher than 43% in 2023/24. These results are comparable to the average quality of the major audit firms, where, in 2025/26, 79% of

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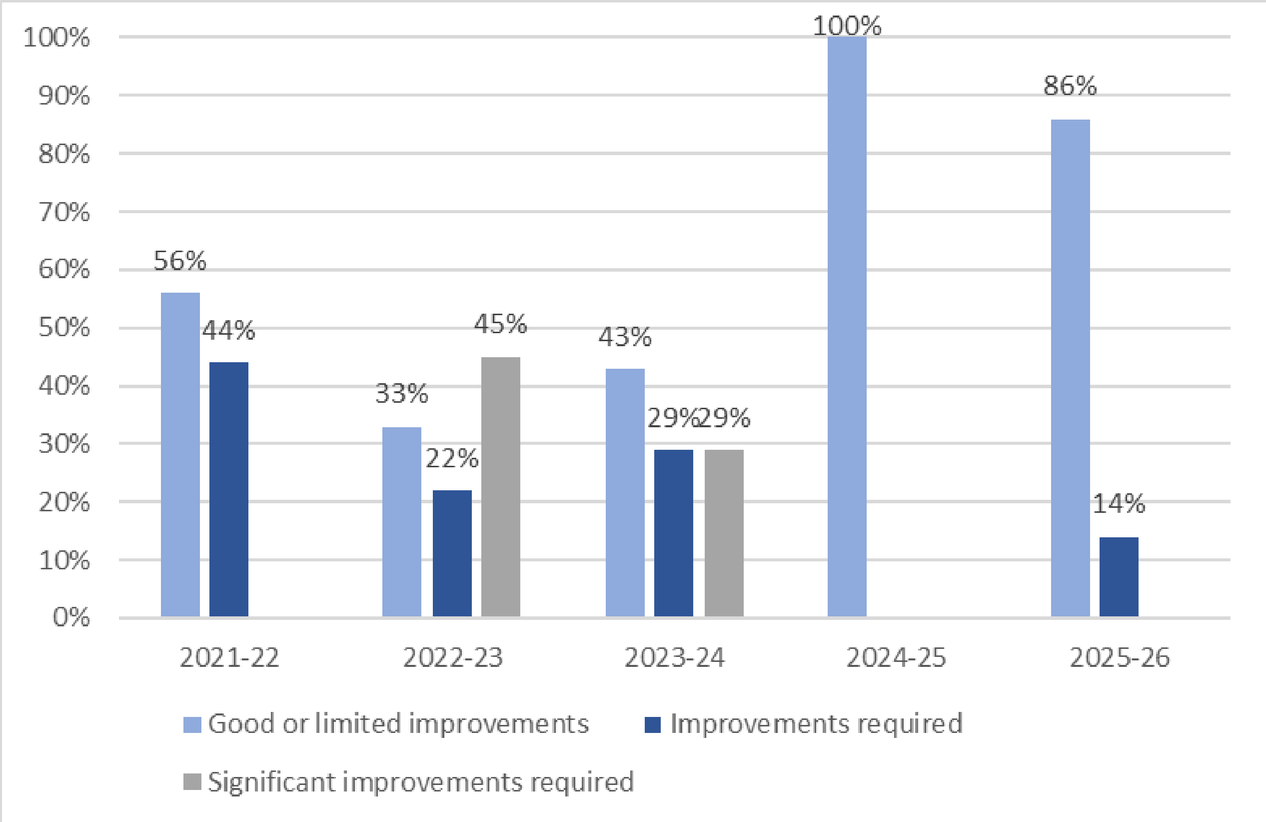
[1]The NAO performed:

- 399 audits as of 31 March 2024, comprising 334 non-Companies Act audits and 65 Companies Act audits; and
- 396 audits as of 31 March 2023, comprising 336 non-Companies Act audits and 60 Companies Act audits.

audits inspected required no more than limited improvements. Details of findings are outlined on page 16.

*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 2025/26 column refers to the NAO's audits of 2024/25 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

Our key findings, which arose on a single audit, related to the need to:

- Improve the audit of Expected Credit Losses (ECL) calculations, particularly the assessment of data inputs and management assumptions used;
- Ensure that derecognition criteria have been met when financial liabilities are extinguished; and

- Evaluate and challenge management assumptions used in fair value assessments when these are not consistent with market practice.

The other six audits inspected required no more than limited improvements. We still had some other findings arising from these inspections, but these arose in a variety of areas and were not indicative of the need to improve audit quality in a thematic manner.

Over the last three inspection cycles we have seen an improvement in audit quality following two years in which it declined. In recent years the NAO has rolled out its Audit Transformation and Quality First programmes, enhanced its audit methodology, developed centres of excellence, introduced new template workpapers, and rolled out new audit software. Enhanced Journal testing software and methodology was used for the first time on the audits we inspected this year. The impact of these initiatives is now being seen in enhanced audit quality, and the good inspection results this year reflect the significant investment made by the NAO.

In the current inspection cycle, we inspected two entities in the financial services sector or with financial services-related balances. One audit was assessed as requiring no more than limited improvements, whilst the other was assessed as requiring improvement. The matters which gave rise to this assessment are set out above. We also identified examples of good practice on five of the audits inspected, which is further indication that audit quality is strengthening. These examples are 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. In response the NAO updated its methodology for journal testing and introduced new software to support this testing. This year we reviewed journal testing on all audits we inspected and had no findings in this area.

It is clear from the FRC's regular meetings that the NAO has prioritised audit quality and the continued roll out of new tools to support this, which ensures audit teams have the necessary skills and equipment to deliver quality audits. We have seen positive actions where the NAO has taken steps to address the findings in our previous reports, including the roll out of the new software for testing journals, enhancement to template workpapers, and further development of and investment in the centres of expertise. As a result of this year's inspection findings, the NAO is reviewing its ECL audit methodology and will be introducing enhancements to address the issues identified.

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
Planning On one audit a joint meeting involving the audit team, management and both auditor and management experts facilitated a robust discussion of the key assumptions supporting the pension scheme valuations. On the same audit involving an auditor expert as part of the deferred tax risk assessment led to effective challenge of management's deferred tax calculation and resulted in the identification of the need for a prior year adjustment. On another group audit the audit team undertook a thorough and detailed risk assessment, evaluating risks at both group and component levels to determine the appropriate audit scope. This responded to the complexities in the group itself and also the changes in auditing standards.

Execution

On one audit the audit team performed a well-corroborated assessment of going concern, obtaining external evidence to validate the sponsoring department's funding support and the timing of an important Government initiative, including direct engagement with sponsor-department officials. It also proactively consulted the NAO's technical team, ensuring that its conclusions and annual report disclosures were robust and aligned with auditing standards. This combination of thorough evidence-gathering and timely technical consultation demonstrated strong professional scepticism and contributed to high-quality audit execution.

On a second audit of an investment entity the audit team obtained and retained on the audit file the working papers prepared and used by its external expert in support of the conclusions set out in the auditor's expert memorandum. This enabled the audit team to evaluate and, where appropriate demonstrate its challenge of, the work performed by the auditor's expert. On the same audit the audit team performed detailed procedures to corroborate the valuation of material underlying investments in funds, specifically for those funds without a service auditor's report and where the fund's year-end differed from that of the audited entity. This included an independent understanding of the underlying material investments, the nature of those businesses and the market within which they operated. This understanding was used to assess how changes to those businesses would, or would not, impact the fund valuation.

On a third audit the audit team prepared a comprehensive workpaper that clearly evidenced the direction, supervision and challenge applied to the auditor expert's work. On the same audit the audit team made effective and efficient use of prior year information in the audit of the valuation of a highly specialised asset. Relevant prior year working papers were brought forward to the current year audit file, with clear documentation to demonstrate their continued relevance. Also, on this audit the audit team clearly articulated the journal selection risk criteria and demonstrated how the planning procedures and the identified fraud risks were explicitly addressed.

On a fourth audit the audit team independently reperformed the consolidation to address the significant risk it had identified over management's consolidation process.

Completion

On one audit the audit team's response to the unadjusted misstatements, being close to group materiality, was to perform a detailed evaluation at the financial statement line item level of the unadjusted misstatements. This assessed whether the misstatements materially affected any individual financial statement line items. The audit team also consulted with its central quality team on the approach.

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

We inspected the NAO under the International Standard on Quality Management (UK) 1 (ISQM 1). The NAO has made significant progress in addressing the matters we raised in our previous reports but acknowledges that there are further improvements to be made and has plans to achieve these.

Our inspection focused on the following areas:

- Annual Evaluation;
- Monitoring and Remediation;
- Governance and Leadership;
- Relevant Ethical Requirements; and

- Technological Resources.

The C&AG concluded that the NAO's SoQM provided reasonable assurance that the objectives of the SoQM were being achieved.

Whilst there have been significant improvements in the SoQM in the year, including to address many of our previous findings, our inspection identified some weaknesses in 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:

- The assessments of the design and implementation of responses to address risks;
- Elements of the monitoring of responses and other sources of information and assessment of identified findings;
- Monitoring the technology used on audit engagements and the broader operation of the SoQM; and
- Monitoring over firms performing contracted out audits to ensure complete reporting of matters that could impact the NAO's compliance with the Ethical Standard.

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

Good practice

We identified the following example of good practice: thorough personal independence consultations and evaluations in the Ethics consultation process.

Following the allocation of a dedicated Supervisor, the FRC has enhanced its engagement with the NAO to support its ongoing efforts to improve audit quality. Recent engagement has included discussions on technology and the NAO's culture and behavioural initiatives. We will continue to support the NAO, sharing insights and good practice, including in areas such as root cause analysis.

NAO's overall response

We welcome the FRC's findings which corroborate our own assessment, informed by feedback from our people and those we audit, that we have made significant strides in improving the quality of our audit work, modernising our audit practice, and putting in place a robust System of Quality Management (SoQM). Through the delivery of our Audit Transformation Programme and successive Quality First Plans the fundamentals for high-quality audit are now firmly in place.

Nonetheless, we recognise that there is more to do. Delivering high-quality audits consistently, on time and efficiently is challenging. We recognise that pressures on the entities we audit continues to create quality risk, as does documentation and review of audit work late in the audit cycle. In addition, as government becomes more digital, more AI-focused and more complex, our own approach needs to keep evolving.

We have set out in our Quality First Plan 2026 how we will address these challenges. It focuses on culture, capability, workload, streamlining and proportionality, digital and data, responsible use of AI, and consistent support for our teams. In particular, it sets out how we will embed our new culture workstream, informed by engagement with our FRC Supervisor, develop an Audit Technology Roadmap under which we will roll out new technologies for use in audit safely and effectively, and streamline our approach for small and less complex audits.

Engagement with Audit Committees

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 aligns 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 ongoing 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.

Controls based audits

In previous reports we have noted that the proportion of audits where the NAO adopts controls (including IT controls) testing, placing reliance on the design, implementation and operating effectiveness of management's internal controls, was lower than that at major audit firms. In 2025/26, 29 audits (9.3% of all audits that were not contracted out to firms) tested the operating effectiveness of internal controls, including six large Government departments. The proportion of audits testing controls is now similar to that found at major audit firms, where approximately 10% of audits use this approach.

NAO's internal quality monitoring results

The NAO's Internal Quality Monitoring (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 all inspections of 31 March 2025 audits were completed by 31 March 2026, allowing remedial actions in response to their findings to be implemented in audits for the 31 March 2026 year-end.

Overall, the NAO's monitoring found that, of the 25 audits assessed, 19 (76%) were judged to be good or requiring only limited improvements, while 6 (24%) were found to require improvements/significant approvements. Appendix 1 provides further details.

2. Review of the NAO's System of Quality Management

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 annually. We reviewed the NAO's design, implementation, and operation of its SoQM, focusing on the components of governance and leadership, relevant ethical requirements, and technological resources. We also reviewed monitoring and remediation and 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.

The design and implementation of responses to address risks

Background

In some instances, controls designated as key were broadly described so that it was difficult to understand how these controls mitigated each risk to which they were mapped.

Finding

Since SoQM responses should be appropriately designed to mitigate risks, the NAO must ensure it describes, with sufficient detail, how the key controls mitigate the specific risks to which they are mapped and evidence how it has monitored the effective design of responses.

NAO's actions

We welcome the acknowledgement of the significant progress made in addressing the findings of the previous FRC report. Our own assessment concluded that we had reasonable assurance over the effectiveness of our System of Quality Management for 2025.

At the same time, we recognised in our annual evaluation that there was further progress to make and set out an action plan to deliver it. Most significantly, we recognised that work to complete the design and implementation assessment of key controls, in response to previous inspection findings, and the consequent monitoring of those controls, was completed late during the year in 2025. As a result, remediation work has been performed in 2026. We have moved to a rolling programme of monitoring and remediation activity through the year for 2026 which is possible as a result of the investment in documentation of controls in 2025 that means we start 2026 with a much stronger baseline than in 2025.

In 2026, and annually ongoing, we will review and update our controlled processes in advance of the monitoring activity. This will include a review of documentation in the risk registers around "how identified processes and controls within them are designed to mitigate the risk," to ensure that the linkage between the controlled process, relevant controls and the risks these are seeking to mitigate is clear.

Elements of the monitoring of responses and other sources of information and assessment of identified findings

Background

The NAO undertook a range of monitoring activities including testing the design and implementation of responses, hot and cold file reviews to assess the effectiveness of responses and controls, trend analysis for any restatement of accounts which had been audited in the previous year, and the staff survey to monitor culture.

The NAO's monitoring of responses also identified 91 findings in relation to the effective design and implementation of responses to risks. Whilst it is reasonable that testing would identify a range of findings, it was not clear how the NAO then assessed how these findings, individually and in aggregate, impacted the mitigation of risks.

It was also unclear how the hot and cold file reviews were sufficiently targeted to provide assurance over the operation of responses. Additionally, the NAO identified 12 themes driving restatements of previously audited accounts and had implemented remediating actions to address nine themes, but did not assess whether the other three themes might represent an unremediated deficiency in the SoQM. Finally, it was not clear how the NAO's assessment of its attainment of culture objectives considered all relevant points from its monitoring of responses and other sources, or the extent of assurance that could be taken from the survey based on response rate of 50%.

Findings

Where monitoring identifies that responses are not designed or implemented effectively, the NAO must evaluate and assess the impact on the mitigation of risks, and whether consequent findings or deficiencies arise in the SoQM. This assessment, and any subsequent changes to responses, should be robustly evidenced.

Where hot and cold reviews are used to monitor the effective operation of key responses, the NAO need to ensure the operating effectiveness of each response is specifically tested and evidenced.

Where the NAO identifies themes in restatements of previously audited accounts that have not been effectively remediated, it must assess if this indicates a deficiency at the annual evaluation date. This assessment must be clearly evidenced.

The NAO must also ensure that its monitoring to assess the mitigation of culture risks considers all relevant sources of information and that it considers the extent of assurance provided by the survey considering its response rate, to determine if further monitoring procedures are needed to assess culture across the broader staff population.

NAO's actions

We welcome the FRC's acknowledgement of the range of monitoring activities we undertook during 2025 and the breadth of findings that arose from this work, leading to the further strengthening of our SoQM.

Our extensive programme of monitoring and evaluation was completed, following the requirements of the quality management standard, by December 2025. All findings arising from our wide-ranging monitoring work during 2025 were assessed and concluded, individually and in aggregate, as part of our annual evaluation. However, we recognise that we need to do more so that we can evidence our continuous assessment of all our findings, including those relating to the attainment of our culture objectives, and whether they represent any deficiency, individually and in aggregate.

Given the timing of elements of our monitoring work, it is inevitable that we will not be able to assess all our findings and subsequent actions and remediation in time to support an annual evaluation. Nevertheless, our rolling annual monitoring plan for 2026 is in place which enables us to undertake work earlier so that we can assess the effectiveness of responses and whether any further actions need to be taken forward.

On the detailed findings above, we will:

- update our documentation to be clear that Hot and Cold reviews are primarily a monitoring activity assessing the effectiveness of Engagement Director Review (a control within the SoQM). Where Hot or Cold review are used to monitor the effectiveness of specific controls within the SoQM, we include specific requirements within the review checklists and document our consideration of the adequacy of coverage through the population samples.

- where our monitoring of PPAs identifies thematic issues that have not been effectively remediated, ensure that we evidence clearly our assessment of whether they indicate a deficiency at the annual evaluation date.

- implement twice-yearly deep dives into culture, through which we review the outputs of the quality survey, including comments, alongside information from wider sources including monitoring findings, root cause analysis, and survey response rates (including action taken to improve participation).

Monitoring the technology used on audit engagements and the broader operation of the SoQM

Background

Except for Apex, the audit software, the NAO did not identify SoQM responses/controls for technology resources in respect of:

- System integrity and user access rights;

- Change management controls for existing technology (including approval, testing and deployment);

- Changes to existing technological resources;

- Controls restricting the use of unapproved tools; and

- Information security controls.

The NAO does have some relevant processes, including testing of General IT Controls (GITCs), but not all of these were identified as specific SoQM responses and so were not monitored for effective design, implementation, and operation.

The assessment and re-certification of technological resources provided by third parties was performed through the Service Provider Assessment process. However, this process was not identified as a key control. Also, it was not clear how the existing governance processes assessed and re-certified in-house developed tools.

Finding

The NAO should reassess the risks for technological resources to identify any risks relating to GITCs, change management, information security, approval processes, training/support, assessment and recertification of third-party and in-house developed tools. It should then identify relevant responses/controls, including processes and mechanisms which already exist but have not been formally incorporated into the SoQM, to address these risks and monitor the design, implementation, and operating effectiveness of these.

NAO's actions

In 2025, our risk assessment and control activity for technological resources focused on Apex, as our key technology platform, alongside change risk associated with the implementation of new technologies. We welcome the findings from the FRC on the positive impact of our new Journals App which was a key change introduced in 2025.

We enforce strict control over the access to technological resources as part of our management of information security, and are certified as ISO 27001 compliant.

In 2026, we are updating our risk assessments to reflect continued developments in technology, now with a focus on the impact of generative AI, and updating our quality management arrangements accordingly. In response to the AQR inspection, and the increasing dependence on technological resources, we are taking the following actions in 2026:

- We are implementing a new Audit Technology Board and a new Audit AI and Advanced Technology Steering Group to oversee the development and deployment of technological resources in audit.
- We will finalise General IT Audit Control documentation in respect of systems on which key SoQM controls are dependent.
- We will perform an annual re-certification of third-party tools and capture it as a control within our SoQM.
- Where not already captured, we will document change management controls in respect of internally developed tools and systems as part of the relevant processes.
- We will update our New Standards Process, to ensure that we capture the implications of changes in auditing and ethical standards on technological resources.
- We will document the annual Service Provider Assessment as a SoQM control covering the completeness of identified technological resources.
- We will recognise a risk in respect of the use of unauthorised technological resources and the related control exercised through restrictions to download of tools to NAO systems.

- We will update our documentation in respect of information security risk and control with specific reference to ISO certification as a key control.

Monitoring over firms performing contracted out audits to ensure complete reporting of matters that could impact the NAO's compliance with the Ethical Standard

Background

The NAO contracts out audit work to external audit firms as service providers. As service providers these firms need to report to the NAO on any potential independence threats relating to the NAO audited entities, including any intentions to bid for non-audit services with an NAO audited body, to enable the NAO to comply with the UK Ethical Standard. NAO oversight is led by the NAO Engagement Director, and the firms must inform FA Ops and the Engagement Director if they intend to bid for any relevant non-audit services, so that these can be assessed by the NAO Ethics Function.

Monitoring of firms' compliance is performed through the regular catch-up meetings between NAO management and the service provider firms. The NAO rely upon the firms' own risks, responses and monitoring to provide assurance that these firms' reporting of potential conflicts is complete.

Going forward, the NAO's framework agreements with these firms will require the firms to report to the NAO on findings arising from their own monitoring of their SoQMs. However, it is not clear how the NAO will achieve assurance over the extent of these firms' monitoring over the design, implementation and operation of their SoQMs, underlying this reporting.

Finding

The NAO need to ensure its monitoring processes, including its engagement with service provider firms, are designed and undertaken to provide sufficient assurance to address all the specific requirements of the Ethical Standard for contracted out audits.

NAO's actions

We take a multi-pronged approach to ensuring that service providers delivering contracted-out audits comply with all relevant requirements, including ethical standards requirements.

At the contract procurement stage, we explicitly assess the firm's quality management arrangements, including their processes for identifying and managing ethical issues. In our recent re-tendering, we have specifically evaluated the firms' conflict identification process as part of our quality assessment. We only contract out audit work to large firms with established quality management processes and a record of delivering high-quality audits in accordance with ethical standards.

During the contracts, our Financial Audit Operations (FA Ops) team manage the ongoing relationships with the relevant firms. Firms are contractually required to notify FA Ops and the relevant Engagement Director of any conflicts of interest or potential non-audit which are then assessed by our Ethics Function. Where no appropriate safeguards can be implemented to mitigate against threats to independence arising the proposed non-audit service is not accepted.

On individual engagements, firms are required to comply with FRC Ethical Standards in line with their own policies and document all relevant matters on the audit file. The contracted-out audit file is subject to review by the NAO engagement team. This review specifically confirms that where threats and safeguards have been identified, in respect of any independence requirements, these are evaluated and assessed at each stage of the audit, and, prior to signing of the audit opinion.

In 2026, we will make further enhancement to our quality management arrangements by requiring firms to report to us on the findings of the evaluations of their SoQMs and considering the impact for our contracted-out audits.

Approach to reviewing the NAO's quality management

We currently undertake a rotational approach for inspection under ISQM 1 with some components reviewed annually and others on a three-year rotational basis. This approach may change as a result of the FRC's revised supervisory approach. The table below sets out the areas of focus for this year and the previous two years:

Current year (2025/26)	Prior year (2024/25)	Two years ago (2023/24)
• Annual Evaluation • Monitoring and Remediation • Governance and leadership • Relevant Ethical Requirements • Technological Resources	• Annual Evaluation • Monitoring and Remediation • Governance and leadership • Information and Communication • Resources	• Design and implementation • Annual Evaluation • Monitoring and Remediation • Acceptance and Continuance

3. Review of individual audits

We set out below the key areas, each of which arose on the same audit, where we believe improvements are required to enhance the NAO's audit quality.

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 audit of Expected Credit Losses calculations, particularly the assessment of data inputs and management assumptions used

Expected Credit Loss calculations are complex since they rely on a number of data inputs and management assumptions. The audit team did not sufficiently test key data inputs or evaluate some significant assumptions used in the calculation.

Ensure that derecognition criteria have been met when financial liabilities are extinguished

Accounting Standards set out clear criteria which must be met in order for a financial liability to be extinguished. The audit team did not challenge the decision by an audited entity's management to extinguish a liability even though it appeared these criteria might not have been met.

Evaluate and challenge management assumptions used in fair value assessments when these are not consistent with market practice

The audit team used an auditor expert to assist with the audit of loans which were reported on a fair value basis. Such a valuation basis requires an audited entity's management to use assumptions which an informed market participant would use. The auditor expert identified one aspect of management's valuation which was not consistent with market practice, but the audit team did not challenge management on this or quantify the impact on the loan valuation.

NAO Actions

We acknowledge the findings of the AQR in respect of this review and have put in place a full set of actions to address them through our audit of the 2025-26 financial statements.

We note that the audit subject to inspection was a company providing loans to support access to finance with an immature loan book, such that market comparable data did not exist. As a consequence, the valuations have a high dependency on management judgement with limited sources of external information with which to challenge. We accept that we could have done more to challenge, and evidence our challenge of, management in this context.

In respect of the audit of Expected Credit Loss valuations, our Financial Instruments Centre of Expertise will develop new tools and guidance of auditing credit risk ratings ahead of the 2026-27 audit cycle.

In respect of the derecognition of financial liabilities, we note that the liabilities related to repayable capital grants from the parent body where the parent body applied symmetrical accounting to recognise the reduction in the corresponding payable. We will request that the entities update the agreements underpinning the management of these liabilities and will review and challenge management's accounting assessment under the updated agreement.

More broadly we will do a full root cause analysis of the factors that led to the areas for improvement on this audit and take action based on the findings. Consistent delivery of high-quality audits, including a focus on the culture required to achieve consistency, is a key focus of our Quality First Plan 2026.

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 2026, 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.

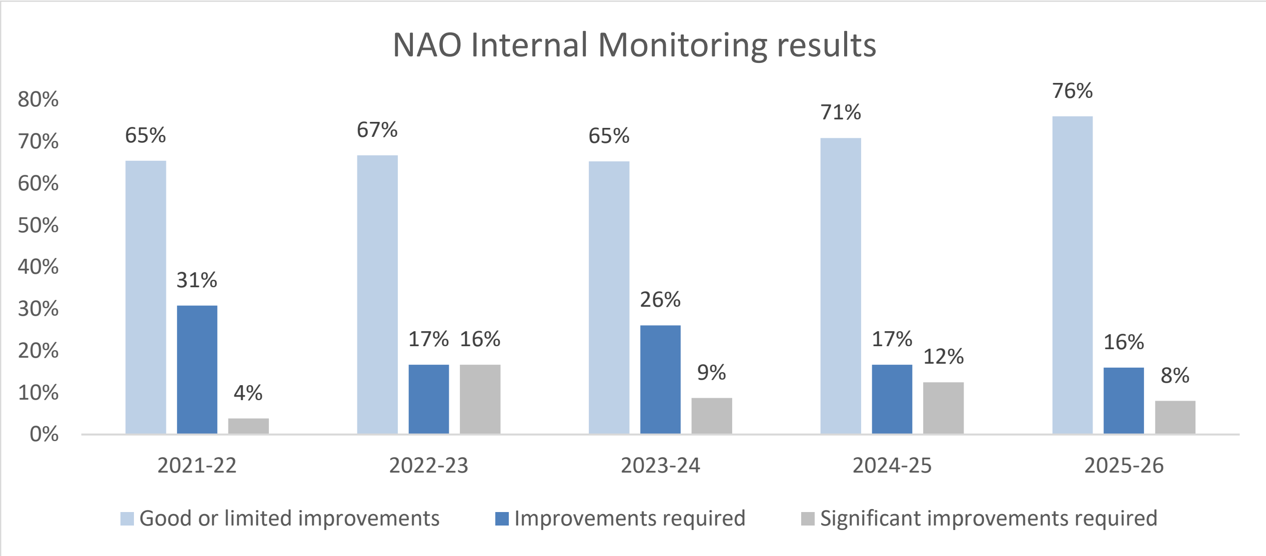
In 2025/26, the NAO inspected 25 of its 2024/25 audits, which represented 6% of all audits undertaken. The number of inspections carried out in the previous three years ranged between 23 and 24, representing a similar proportion of all audits undertaken in each year.

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 2026. The results of this programme and comparisons to previous years, are set out below.

The NAO's analysis of the six audits which did not meet its quality standards showed that the results were largely driven by a small number of specific, well-defined issues. Notwithstanding these matters, here has been a consistent improvement in observed audit quality over the last three audit cycles.



Given the sample size, changes from one year to the next in the proportion of audits moving within each category cannot be relied upon to provide a complete picture of a firm's performance or overall change in audit quality.

* 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 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 regularity - an entity's compliance with the framework of authorities covering their use of resources set 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.