

# 2

## THE NATIONAL AUDIT OFFICE

---

### ROLE OF THE NATIONAL AUDIT OFFICE (NAO)

---

#### Background

**2.1** The National Audit Office (NAO) was created by the National Audit Act 1983 and is funded directly by a Parliamentary Supply grant agreed by the Public Accounts Commission. It operates independently of the Government.

**2.2** The role of the Comptroller and Auditor General (C&AG), as Head of the NAO, is to report to Parliament on the spending of central government money. The C&AG is, by statute, an Officer of the House of Commons and all main work of the NAO is presented to Parliament by Order of the House.

**2.3** The NAO conduct financial audits of all government departments and agencies and many other public bodies, and reports to Parliament on the value for money with which public bodies have spent public money. The NAO's relations with Parliament are central to its work, and it works closely with the Committee. It also works closely with relevant public audit bodies that have a role in other areas of public expenditure.

#### Financial Audit

**2.4** Under the law, the C&AG and the NAO are responsible for auditing the accounts of all Government departments and agencies and to report the results to Parliament. Individual accounts can range from the Department for Work and Pensions, to the Passport Agency. The C&AG also audits over ninety per cent of the 'arms-length' public bodies (known as Non-Departmental Public Bodies or NDPBs) such as the Legal Services Commission. The C&AG is also responsible for auditing all National Loans Fund accounts, several international clients, such as the International Labour Organisation and the European Agricultural Guidance and Guarantee Fund.

**2.5** As with other auditors, the C&AG is required to form an opinion on the accounts as to whether they are free from material misstatements. The C&AG is also required to confirm that the transactions in the accounts have appropriate Parliamentary authority. If the NAO identify material misstatements, the C&AG will issue a qualified opinion and prepare a report. Where there are no material errors or irregularities in the accounts, the C&AG may nonetheless prepare a report to Parliament on other significant matters and these reports may be considered by the Committee. Even if no report is made, the NAO will still, where appropriate, write a letter to the management of a body outlining where improvements in their systems could be made.

**2.6** NAO's financial audits are subject to an annual independent assessment by the Quality Assurance Directorate (QAD) of the Institute of Chartered Accountancy in England and Wales (ICAEW).

## Added Value Assignments

**2.7** A recent development in the NAO's approach to financial audit has been the development of **Added Value Assignments**. These are discrete assignments designed to enhance the quality of service to Parliament and audited bodies by examining key issues of propriety, governance and financial management that are not essential components of certification coverage.

**2.8** The identification of such assignments can arise from many sources: as part of the risk analysis that informs the audit planning approach; as a response to a weakness or development area identified as part of the financial audit process; or to address concerns raised by Members of Parliament regarding the propriety or economy of particular areas of public expenditure. The main criteria of this work however, is that the assignments are designed to focus on issues where the audit team feel they can 'add value' to the audited body. Indeed audited bodies have been very receptive to the assignments performed to date, and have implemented a variety of improvements in their controls and governance structures as a result of the work.

**2.9** The results of assignments will normally be communicated to the audited body by way of an internal report, although some assignments may lead to the publication of findings and be heard by the Committee of Public Accounts.

**2.10** Some examples of areas covered by added value assignments relate to financial audit work are:

- A review of audited bodies' implementation of risk management strategies.
- A review of a department's sponsorship of its non-departmental public bodies and how this may be improved.
- A review of a major department's IT controls.
- Reviews of the implementation of major new programmes in government departments.
- A review of the grant awarding procedures of a major non-departmental public body.

## Value for Money Audit

**2.11** Around 60 reports to Parliament are presented each year by the Comptroller and Auditor General on the value for money with which Government departments and other public bodies have spent their resources. Under the 1983 National Audit Act, the NAO can examine and report on the economy, efficiency and effectiveness of public spending.

**2.12** The NAO use the following definitions for the 'three Es':

**Economy:** minimising the cost of resources used or required – **spending less**

**Efficiency:** the relationship between the output from goods or services and the resources to produce them – **spending well**; and

**Effectiveness:** the relationship between the intended and actual results of public spending – **spending wisely**.

**2.13** The value for money work covers a wide range of issues. Reports range from examining the entire operation of the criminal justice system to the major procurement projects of the Ministry of Defence and the administration of European Union schemes by the Department for Environment, Food and Rural Affairs. The NAO identifies topics for examination from careful monitoring and analysis of the risks to value for money across the full range of its responsibilities and discusses the scope with the departments.

## Relations with other Public Audit Bodies

**2.14** As the auditor of central government expenditure, the NAO is the principal state audit body in the United Kingdom. Other bodies are responsible for other aspects of public spending in the UK. The Audit Commission is responsible for appointing the auditors for local authorities and local health service bodies in England and Wales and for promoting value for money in these sectors. The Auditor General for Scotland, supported by Audit Scotland, is responsible for auditing the expenditure of the Scottish Parliament and Executive and reporting to that Parliament. Staff at Audit Scotland are also responsible for local authority audit in Scotland.

**2.15** The audit arrangements in Wales are changing with the creation of a "Wales Audit Office" headed by the Auditor General for Wales with responsibility for the work currently undertaken by the National Audit Office and the Audit Commission in Wales. The Comptroller and Auditor General for Northern Ireland and the Northern Ireland Audit Office do a similar job in respect of the Northern Ireland Assembly. If the NI Assembly is not in operation, reports go directly to the Westminster Parliament. In these circumstances, Northern Ireland Accounting Officers may be expected to appear before the Committee.

**2.16** The various public audit bodies work as closely as possible together to share good practice. To this end, they have established a **Public Audit Forum** to act as a focus for developmental thinking on public audit.

**2.17** The European Court of Auditors (ECA) is responsible for auditing European Union expenditure in all EU member states, including the United Kingdom. The NAO acts as a liaison point between the ECA and UK departments. The NAO also report regularly to Parliament on issues relating to the expenditure of EU funds in the UK, and on occasion, on wider issues of financial management within the European Union.

## THE NAO RIGHT OF ACCESS TO INFORMATION

### General

**2.18** For the purposes of examination of a government department's accounts the C&AG has a statutory right of access (as provided for in the Government Resources and Accounts Act 2000, sections 8(1), 8(2), 25(4) and 25(5)) at all reasonable times to any of the documents relating to departments' accounts and, further, a person who holds or has control of any of those documents is obliged to give the C&AG any assistance, information or explanation which he requires in relation to any of those documents. These rights apply only in relation to documents that are held or controlled by a government department or in pursuance of arrangements made by a department for the compiling or handling of any of its financial records. Section 25(8) of the Act enables Treasury to make an Order widening the range of documents to which the section 8(1) right applies to include documents held or controlled by other bodies.

**2.19** Similar rights apply where the C&AG audits the accounts of other bodies under an enactment or by agreement. Section 11(5) of the Government Resources and Accounts Act 2000 provides the C&AG with a statutory right to ask auditors of bodies designated for inclusion in Whole of Government Accounts for such information and explanations as he or she may reasonably require for his or her examination.

**2.20** In addition, for the purpose of carrying out value-for-money studies, section 8 of the National Audit Act 1983 provides the C&AG with a statutory right of access at all reasonable times to all such documents as may reasonably be required, provided that the documents are held by or under the control of the department or body concerned. The C&AG is also entitled to an explanation of the documents, and the Finance Director or his or her staff should normally arrange this. The Government will seek to facilitate access for VFM studies to the same classes of bodies to which the C&AG has statutory access under the GRAA Order. This will be done through such mechanisms as conditions on grants and clauses in contracts.

**2.21** The C&AG is thereby, for example, given access to:

- all manual or computerised records relating to the income and expenditure and assets and liabilities appearing in the accounts; and
- departmental correspondence and minutes held on files and working papers which are relevant to value-for-money studies being undertaken.

NAO staff are cleared to see security classified papers; they may therefore see such papers, subject to the normal security rules e.g. Top secret papers should be released only to those cleared to see them.

**2.22** Papers primarily concerned with the formulation of policy by ministers will not normally be relevant to value-for-money studies. The C&AG is not, therefore, generally given access to Cabinet or Cabinet Committee papers or minutes. If the C&AG should request access to specified Cabinet or Cabinet Committee papers on the ground that he or she considers it necessary for the purpose of audit, the Cabinet Office should be consulted. The folders of Ministers' private offices are by custom, not made available to NAO.

**2.23** Where departmental activities are contracted out, the C&AG should continue to have access to any document held by the contractor which is necessary for the C&AG to meet his or her statutory duties.

**2.24** In the past, papers that dealt with the conduct of departments' business with the NAO were in certain circumstances been given the designation "Not for NAO Eyes" (NFNE). Following correspondence between Treasury and departments at official and Ministerial levels in 1997, the Government dropped the use of this designation on official papers. The change was retrospective and the designation should therefore be ignored on all previous papers.

## Non-Departmental Public Bodies

**2.25** As part of implementing recommendations in the Sharman Report NAO would now audit all executive NDPBs whether or not they receive direct Government funding. For existing NDPBs this will happen as and when their existing external auditor contracts come to an end. For new NDPBs the NAO will either be made external auditor through primary legislation or by the Treasury through an Order under the Government Resources and Accounts Act 2000. This would enable the C&AG to bring to the attention of Parliament, where appropriate, any material departures by the body from the requirements of regularity and propriety and other government accounting rules, including any material cases where expenditure does not conform with conditions attached by the sponsoring departments. The right of inspection confers the right to carry out value-for-money studies by virtue of section 6 of the National Audit Act 1983.

## NAO VALUE FOR MONEY STUDIES

### Statutory Basis

**2.26** The National Audit Act 1983 provides a statutory basis for the C&AG's value-for-money studies. Under section 6, the C&AG may at his discretion carry out examinations of the economy, efficiency and effectiveness with which any body to which this section applies has used its resources in discharging its functions. The bodies concerned are mainly government departments and other public bodies where the C&AG is the statutory auditor or where the C&AG has statutory rights of inspection. **The Act specifically precludes the C&AG from questioning the merits of the policy objectives of the department or body concerned.**

**2.27** Under section 7 of the Act, the C&AG also has the right to carry out such examinations in any authority or body appointed, or whose members are required to be appointed, by or on behalf of the Crown, in any year in which the body receives more than half its income from public funds (nationalised industries and some other public authorities being excluded).

**2.28** The 1983 Act also provides, in certain circumstances, for the C&AG to undertake value-for-money studies in bodies where the C&AG audits the accounts by agreement or where the C&AG has inspection rights as a result of agreements between the appropriate minister and the body concerned.

### Procedure

**2.29** Where the C&AG proposes to carry out a major value-for-money examination, the scope and timing of the work is normally discussed between the NAO and staff in the department or body concerned. The NAO usually announces in advance that it will carry out a value for money study or other investigation. The subjects may arise through audit findings, or from concerns expressed in Parliament, the media, or elsewhere.

**2.30** Departments are expected to co-operate fully with the investigation and to give the NAO all assistance it can. On completion, findings and conclusions are set out in a draft report, which is sent to the Accounting Officer for comment on the accuracy and completeness of the facts and their presentation.

## Departmental Responsibilities

**2.31** The Finance Director is responsible for managing their department's relations with the NAO. The Director is expected to:

- undertake the liaison needed on NAO value for money studies and reports concerning the department;
- take the lead in ensuring that C&AG reports correctly reflect the department's position before the Accounting Officer agrees to its publication; and
- be responsible for co-ordinating the briefing of the Accounting Officer for any PAC hearing which flows from the report.

**2.32** The conduct of NAO examinations and the preparation of reports go through a number of stages.

- The NAO normally first discuss with the department the scope and methods proposed for the examination. If an Accounting Officer has any reservations about the scope, methods, and the timing, these should be make plain to the NAO at this stage, so that they can be fully considered.
- When the examination has been completed an outline report is normally prepared and shown to and discussed with the department.
- A full draft report is then given to the Finance Director to be considered by the departmental officials who are primarily concerned with the area of study and to any relevant third parties.
- A subsequent final draft is sent by the NAO to the Accounting Officer.
- The NAO also gives the Accounting Officer an opportunity to comment on any press release that they intend to issue when the report is published.

## Use of Consultants and Secondees by NAO

**2.33** The NAO may engage the services of outside consultants to assist in their studies. In each case, departments need to consider the competence of the consultants, potential conflicts of interest with any other work the consultants may be doing for the department, and their access to departmental papers including classified information. In general, the NAO's consultants have the same rights of access to papers as NAO staff have, although this may not be appropriate in certain circumstances. The extent to which outside consultants should be given access to information (including classified material) is set out in detail in **DAO 2/90** and should be decided on a case by case basis before they start work on a study.

**2.34** Some of the same issues may arise with secondees to the NAO. The NAO would inform departments of proposals to use secondees on studies, so that any possible sensitivities can be considered.

## Agreeing Draft Reports

**2.35** Departments should check draft NAO reports meticulously at every stage. If any part of a draft report, including the Summary and Conclusions, contains statements of fact, implications, opinions or recommendations with which an Accounting Officer disagrees, or which he considers are unfairly presented, this must be made clear to the NAO. If the C&AG does not agree to amend or remove the disputed material, the Accounting Officer should ensure that his or her disagreement and reasons are included in the report alongside the statements concerned. This should be done whether or not the disputed statements are attributed in the text to the NAO. Similarly, while the scope of an NAO examination ultimately remains a matter for the C&AG, in any case where an Accounting Officer's initial reservations have not been fully met he should ensure that his or her views are stated in the report.

## Cross-Governmental Recommendations

**2.36** On occasions, the NAO make recommendations that apply across government. If any such recommendations are proposed in a department's VfM studies, these should be brought to the attention of the Treasury (see contacts at the end of the Guide) so that it can take a view on wider implications. Departments should not sign up to, as a matter of practice, any recommendations that go beyond their area of responsibility.

## Publication of Reports and Publicity

**2.37** The NAO usually puts out a press release on the day NAO reports are published. These highlight the main findings of the investigation. The NAO also gives the Accounting Officer an opportunity in advance to comment on any press release which they intend to issue on the day the report is published.

**2.38** In giving immediate comment on NAO reports departments should be careful not to pre-empt or prejudice the Government's evidence to be given at a Committee hearing, nor anticipate what the Government might say in response to any subsequent PAC Report.

## GOOD PRACTICE

- **Nominate someone to co-ordinate the clearance of draft reports and to monitor progress, and let NAO know who that person is.**
- **Involve staff responsible for the policy under study right from the start to avoid any misunderstandings later in the process.**
- **Keep the Accounting Officer(s) informed as the report progresses so that nothing comes as a surprise rather late in the process.**
- **Keep proper notes of what has been agreed or disagreed with the NAO.**
- **Take NAO deadlines for clearing draft reports seriously. Failure to respond could lead to NAO publishing a report without departmental agreement as some of the PAC hearing dates are fixed in advance.**
- **Brief Ministers and the departmental press office on the report before it is published so that they are not caught unaware and can respond to any queries.**
- **Keep in touch with the NAO auditor responsible for the report to be sure about publication date, also check the NAO website for this regularly as a matter of practice.**
- **Consider the need to brief No 10 if the subject of the report is in the news, the findings and recommendations are likely to be of interest to the media or could be critical of Government.**
- **Ensure that the Accounting Officer is consulted when commenting on the draft NAO press release; consider the need for own press release.**
- **Have a proper monitoring system to track implementation of recommendations. This will be handy for any subsequent study or PAC hearing.**
- **Keep your department's audit committee fully informed on all NAO and PAC reports and progress with the implementation of recommendations.**
- **Be prepared in advance to brief the Accounting Officer and other officials at short notice as some PAC hearings can take place within days of publication of the NAO report.**

## RELEVANT GUIDANCE

DAO letter AAL/1, of 30 June 1989 "PAC Hearings: The Accounting Officers' Responsibilities". On the Treasury's website at:

- [www.hm-treasury.gov.uk/media//483F4/dao89pachearing.pdf](http://www.hm-treasury.gov.uk/media//483F4/dao89pachearing.pdf)

DAO 2/90 "NAO use of Consultants". On the Treasury's website at:

- [www.hm-treasury.gov.uk/media//7186B/daor0290.pdf](http://www.hm-treasury.gov.uk/media//7186B/daor0290.pdf)