

## STATUTORY AUDIT SERVICES MARKET INVESTIGATION

### Summary of hearing with the National Audit Office held on 4 June 2013

#### Introduction

1. The Sharman review issued in 2001 recommended that the Comptroller and Auditor General (C&AG) should continue to contract out work to private firms to help encourage competitive tension and benchmark the efficiency of the NAO. The review recommended that 25 per cent of audit work be contracted to private firms, and this had been achieved. The NAO also used this to benchmark itself on price and audit methodology.
2. When outsourcing its audits, the NAO was required to follow the EU procurement rules. This was a detailed but not necessarily onerous process. Firms were appointed to a portfolio of engagements which specified the minimum and maximum fee level over a three- to four-year period. NAO engagement directors, in conjunction with central decision-makers, then considered which audit work was to be outsourced.
3. The NAO contracted-out full and partial audits and also drew on specialists from the firms to provide specific technical advice on audits conducted in-house, as appropriate (for example, to challenge actuarial assumptions and valuations).

#### Assessment of firms

4. The NAO applied the following criteria when selecting firms:
  - the quality of the audit work—this considered the Transparency Report produced by the firm, details of the experience of the firm and staff and the resourcing model utilized;
  - methodology;
  - capacity of firms, ie:
    - skill set;
    - number of staff; and
    - specialist skills; and
  - country coverage
5. The Big 4, Mid Tier and consortia of firms bid for NAO work. When awarding the contracts, the NAO did consider costs but they were not an ultimate overriding factor when outsourcing an audit. Service quality was the main consideration and feedback was sought from clients on this aspect.

#### Rotation

6. The NAO had internal rotation policies for engagement directors and other staff. It generally did not contract-out for a protracted period since that might lead to a loss of expertise within the NAO with regard to a particular client. The NAO had adopted a

five-year engagement director (partner equivalent) rotation policy in line with the ethical standards.

## Fees

7. The NAO worked alongside firms during the course of the audit and in particular at the planning stage in the first year of the firm's engagement. Firms submitted their proposed fees (based on the agreed contract rates) and fees were agreed by the NAO with the client. The NAO looked to achieve full cost recovery on all audits (excluding any VAT charged by the firms).

## Contracting-out audits to private firms

8. Contracting audit engagements out to private sector firms allowed the NAO to benchmark its own methodology and audit approach to gauge best practice in external audit (including the reliance on controls, computer-assisted audit techniques and analytical procedures). It also allowed the NAO to demonstrate to the client that they were receiving good value.
9. Feedback from clients did note continuity as an issue (ie clients did not welcome overly frequent changes in personnel) whilst recognizing that a change in personnel was also beneficial. Continuity at the different levels in a team was desired to avoid having to explain the same issues over again.
10. The best feedback was awarded when members of the engagement team moved from junior to more a more senior position with that client's engagement team over the course of a number of years. The greatest impact on clients was the change of an audit lead (ie the qualified member of staff responsible for day-to-day supervision of the audit team on site). The NAO noted that new auditors may identify issues because they brought a fresh perspective.
11. Where the NAO acquired new clients who had previously been audited by another body or firm (typically companies wholly owned by the Government), some additional costs were incurred from the change in auditor, although these were managed as the NAO would request access to the former auditor's working papers. When the NAO contracted-out an audit to a firm, this was carefully managed and the firm was supported by the NAO in order to understand the business fully. This included full access to papers and previous audit team members. In addition, there was also a level of joint working. This would exceed the support provided when there was a change of auditor in the private sector and helped with transition. There was no budget allocated for directors to get up to speed on new audits. However, it was accepted that the costs would be higher in the first year. The change of team members on existing audits was mitigated by ensuring that managers and leads were not all rotated at the same time. A fully new audit team would be fully up to speed by the interim and final audit.

## Independence

12. The NAO expected to maintain a constructive working relationship with any firms conducting work on its behalf. It was very keen to ensure that firms maintained professional scepticism and independence and that this could be demonstrated.
13. Because the C&AG was still legally required to issue an audit opinion (in addition to assurance provided by the contracted firm to the NAO), the NAO would still attend Audit Committee meetings and review the contracted firm's audit files. It would form a

view on the level of professional scepticism and independence by discussions with the audit team, review of the file and consideration of the audit findings and the level of acceptance/challenge of management recommendations. The NAO would assess these issues both when the audit was planned and when it was conducted.