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Chair
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House of Commons
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23 February 2023

Dear Mr Bacon,

NATIONAL AUDIT OFFICE STRATEGY: PROGRESS UPDATE AND ESTIMATE MEMORANDUM 2022-23

1. At its forthcoming meeting, the Public Accounts Commission will be considering the NAO's 2023-24 Estimate memorandum and progress update on its strategy for the years 2020-21 to 2024-25. This letter offers the Treasury's advice on these documents in accordance with our responsibilities under Section 23 and Schedule 3 Paragraph 1 of the *Budget Responsibility and National Audit Act 2011*.
2. HM Treasury welcomes the NAO's engagement in advance of the Commission's meeting to explain and answer questions on their Estimate. The following points have been discussed with them previously and noted as items that we will be drawing to the Commission's attention.

Overall costs

3. The NAO's Progress Update and Estimate Memorandum sets out a net expenditure of £91.1m for 2023-24, an increase of 8.6% on 2022-23. They report that this increase is primarily driven by increases in staffing costs and the cost of external suppliers of audit services.

Pay and reward

4. The NAO have proposed an increase in overall pay costs of just over 6 %. This can be broken down into two components: an increase in the pay settlement of 4% year on year; as well as a package of reforms to the NAO's pay and reward structures.
5. The NAO have noted that inflation has driven up the wages of professionals in the audit sector, and that this has had an effect on their ability to recruit and retain staff. With this in mind, in addition to the 4% pay settlement growth, they are planning reforms to pay and reward structures, including creating an additional grade and increasing the rate at which staff progress towards the mid-point in each pay-band. The beneficiaries of this increase will see pay increases above the wider 4%.
6. The Commission may want to explore several aspects of this, including any evidence on the size of the pay differential with the private sector, and the precise nature and extent of the challenges this is creating for recruitment. It may also be of interest to understand the effect that the changes to pay and grade structures will have on cost increases in future years, and whether the changes will be sufficient to ensure necessary levels of qualified staff without leading to significant disparities with the wider public sector.
7. The Commission may also wish to have regard for the government's approach to other public sector pay awards this year, set out in its recent remit letters to public sector pay review bodies. These state that pay awards must strike a careful balance – recognising the vital importance of public sector workers, while delivering value for the taxpayer, considering private sector pay levels, not increasing the country's debt further, and being careful not to drive prices even higher in the future.

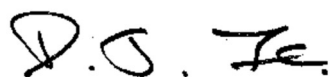
External audit costs and contractors

8. The other core driver of increased overall costs reported by the NAO is the rising cost of bringing in external, private sector, auditors to support their audit work. Currently, around one fifth of the NAO's audit work is carried out by external auditors, including some audits for arms-length bodies, carried out under contract to the NAO; as well as external auditors contracted to provide technical support in specialised areas (e.g. pricing of assets). Inflation within the audit sector has driven up fees for both types of contracted out work.

9. The Commission may want to explore whether the additional costs of contracted out audits are being adequately captured in fees to the non-core bodies largely audited via external auditors under contract. Given higher private sector wages, it may be worth assessing whether the ratio between in-house and contracted-out audits remains cost effective, and whether a case exists for bringing more of this work in-house.
10. It may also be helpful to understand whether the increased demand for specialist external expertise is being driven by a structural increase in the complexity of the public bodies being audited, and whether it would be possible or desirable to bring more of this specialist technical expertise in-house.

Staffing and resourcing

11. The NAO propose to increase their overall headcount from 940 to 948, reflecting both a reduction in staff required to scrutinise Covid related spending, offset by an increase related to the introduction of the ISA315 standards. This diverges from previous plans to reduce staff in 2023-24 and 2024-25.
12. The Commission may wish to explore the impact that the introduction of these new standards is having as a driver of resource pressures within the NAO, whether this will be a permanent increase, as well as the extent to which novel work (e.g. UK government energy schemes, or spending in Scotland, Wales and Northern Ireland) may also affect staffing requirements.
13. The NAO have set out a plan to return the proportion of audits certified before summer recess to pre-Covid levels by 2024. The Commission may want to enquire whether the NAO think this could be achieved more quickly if they had additional financial audit resources in 2023-24.
14. I am copying this letter to the Comptroller & Auditor General.



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