

# Audit quality

Annual report

2017/18



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# Appointments and Assurance Team

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This report has been prepared by the Appointments and Assurance Team who are responsible for applying the new [Audit Quality Framework](#) across all financial audits and performance and Best Value audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission.

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Appointments  
and Assurance  
Team

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# Key messages

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Audit Scotland is committed to providing high quality audits to the public sector in Scotland. This is detailed in [Public Audit in Scotland](#), which sets out the principles and themes of public audit and how it fits with and responds to the public policy environment in Scotland. Audit Scotland exists to support the work of the Auditor General for Scotland and the Accounts Commission.

A new [Audit Quality Framework](#) established in December 2017 introduced new working arrangements that go beyond regulatory requirements and provide assurance over all audit work and providers, including Best Value and performance auditing. The Framework complements [Public Audit in Scotland](#) and the [Code of Audit Practice 2016](#) (the Code). These documents require auditors to comply with the highest professional standards, including International Standards on Auditing (UK) and the Financial Reporting Council's Ethical Standard. The Framework has led to greater consistency in measuring audit quality across all audit work.

The Institute of Chartered Accountants in Scotland (ICAS) carries out independent assurance reviews under the framework covering financial audit, performance audit and Best Value work. The reviews include annual coverage of the work carried out by Audit Scotland auditors and all appointed firms over the five-year appointment. These independent reviews are a significant development in assessing audit quality and provide the highest level of assurance to all stakeholders.

There is strong evidence of compliance with auditing standards and the Code, and overall good levels of other evidence of audit quality with some limited improvements identified for audit work delivered in the period 1 April 2017 to 31 March 2018. Areas for improvement and future focus are outlined on [page 25](#) of this report.

Evidence of compliance with audit standards includes:

- All financial audits subject to independent review by ICAS were awarded a 2A score indicating “financial statements audits were of a generally acceptable standard”. The scoring methodology is outlined on [page 17](#) of this report.

- 68% of internal quality reviews carried out by all providers achieved a 2A score. Areas for improvement are identified on [page 25](#) of this report.
- Auditors completed 96% of financial audits on time.
- Between 95% and 100% of financial audit staff are either qualified or in professional training.

Other evidence of audit quality and impact includes:

- Auditors have embraced the Code requirements and have reported in annual audit reports delivery of wider audit dimensions.
- Stakeholder feedback shows satisfaction across a range of impact measures
- All auditors demonstrate a strong culture of support for performing high-quality audit work.
- Fees for non-audit services and expected fees above threshold levels were all approved appropriately.

As part of Audit Scotland and the Accounts Commission's ambition for world class audit, the ongoing focus on audit quality will seek to secure improvements identified through the 2017/18 audit quality review activity, for example where compliance reviews highlighted scope for improvement in the standard of audit documentation. There is an opportunity now to take stock of the impact achieved through implementing the Audit Quality Framework and consider areas for further development including:

- the extent to which performance and Best Value work should comply with International Standards on Auditing (ISAs)
- the range of KPIs and trend data available to help track ongoing performance
- a more co-ordinated and consistent approach to acquiring stakeholder feedback
- appropriate assurances on the quality of Best Value auditing in the local government sector.

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# Introduction

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This report has been prepared by the Appointments and Assurance Team (AAT) on behalf of Audit Scotland. The AAT provides assurance on audit quality to the Auditor General and the Accounts Commission and is led by an Assistant Director. The team does not conduct audit work and is independent from auditors. The AAT applies the Audit Quality Framework across all audit work and providers and carries out direct reviews of work delivered by Audit Scotland and the firms. It draws evidence from independent reviews carried out by the ICAS, the Financial Reporting Council and other independent sources.

The AAT also supports Audit Scotland's Ethics Partner and provides advice and guidance to staff, firms, the Accounts Commission and the Auditor General on ethical standards issues in accordance with the Ethical Standard.

Producing high quality audit work is critical in delivering Audit Scotland's ambition for world class audit. A revised Audit Quality Framework covering all audit work and providers was developed to assess and improve audit quality, recognising the greater public scrutiny of the audit profession and the role of auditors.

Audit Scotland has made structural changes to better support an independent assessment of quality including the creation of the new AAT and procuring independent assurance reviews from ICAS. The quality results contained in this report provide baseline data and will allow us to further develop trends over time.

This report summarises the detailed assessment of audit quality carried out on audit work delivered by Audit Scotland and the appointed firms on behalf of the Auditor General and the Accounts Commission in 2017/18. The report provides evidence that Audit Scotland and the appointed firms have designed and implemented effective audit quality arrangements to assure the quality of their audit work. The results of internal and external reviews of audit quality provide assurance to the Auditor General and the Accounts Commission. The report also highlights areas for further improvement.

The Audit Quality Framework has been used to direct the programme of work on which this report is based. The Framework was designed to strengthen audit quality arrangements at several levels and:

- introduced independent external assurance across all audit work improving comparability and robustness
- improved consistency of approach across all audit work and providers
- extended reporting of audit quality work and increased its transparency.

This report provides an assessment of audit quality in terms of the key roles, the inputs and the outputs as described in the diagram below.



This report has been prepared to meet the principles of the [Statutory Auditors \(Transparency\) Instrument 2008](#). Although the requirements of the instrument do not apply to Audit Scotland this report is produced to comply with best practice, and provide explicit assurance to the public on the quality of audit work performed on their behalf.



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# Key roles in governance of audit quality

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## Auditor General and Accounts Commission

The Auditor General and the Accounts Commission published [Public Audit in Scotland](#) to set out the shape, principles and themes of public audit, and how auditors carry it out. The Auditor General and Accounts Commission have adopted a joint Code of Audit Practice, a rigorous joint procurement process that is independent of the individual audited bodies, and a joint Audit Quality Framework.

The Auditor General is responsible for central government, NHS and further education college audits, while the Accounts Commission is responsible for local government audits, including integration Joint Boards. Both appoint auditors to conduct the financial audits. The Auditor General and Accounts Commission consult widely to set their performance and best value [work programme](#), however the statutory responsibilities for the programme rest solely with the Auditor General and Accounts Commission.

The Auditor General and the Accounts Commission's governance of audit quality is of fundamental importance to their roles. Both receive assurance reports from the AAT on audit quality during the year and details of actions taken in response to findings. The Accounts Commission use this report to inform the audit quality section in their annual report.

## Audit Scotland's Board

The Audit Scotland Board and its audit committee exercise a governance role in respect of audit quality. The Board approves the Audit Quality Framework and obtains assurance from the independent AAT through their biannual reports on audit quality. The audit committee's remit includes advising the Board on the arrangements for audit quality monitoring and reporting, receiving biannual reports on quality, and considering the Audit Quality annual report prior to consideration by the Board. Details of Board members are set out in the Appendix.

## Ethics Partners

Audit Scotland has designated the Director of Audit Services as the Ethics Partner. This position needs to have the necessary seniority, relevant experience, authority and leadership role to ensure compliance with the Financial Reporting Council's Ethical Standard. The Director of Audit Services is a member of Audit Scotland's management team and has direct reporting lines to the Board.

The Ethics Partner role encompasses responsibility for the adequacy of policies and procedures relating to integrity, objectivity and independence, including communication on these matters and providing guidance to achieve a consistent application of the Ethical Standard. Where appropriate, Audit Scotland's Ethics Partner role also extends to advising the Audit Scotland Board on ethical matters arising in respect of firms' auditors although each firm is also required to have an Ethics Partner with primary responsibility within the firm for compliance with the Ethical Standard.

## Audit Scotland and appointed firms

Public audit is carried out by Audit Scotland auditors and appointed firms who are subject to a rigorous and open procurement process. Approximately two thirds of financial audits and audit of Best Value work is carried out by Audit Scotland auditors with the remaining third conducted by appointed firms. Performance audit work is carried out by Audit Scotland auditors.

Audit Scotland's management team oversees the day-to-day operations of Audit Scotland's work. The management Team is led by the Chief Operating Officer. The Director of Audit Services Group is responsible for the quality of financial audits delivered by Audit Scotland's in-house audit practice in accordance with International Standard of Quality Control 1 (ISQC1). The Director of Performance Audit and Best Value and Controller of Audit is responsible for the audit quality arrangements for performance audits, Best Value auditing and other statutory reports. Further details of the management team are set out in the [Appendix \(page 26\)](#).

Audit Scotland's management of audit quality is supported by an Audit Quality Committee that includes representatives from the Audit Services Group and Performance Audit and Best Value Business Group. It is responsible for overseeing the quality control programme of financial, performance and Best Value auditing and identifying training needs arising out of that work. Audit Scotland's Professional Support team carries out the work commissioned by the Audit Quality Committee.

Each appointed firm has its own arrangements for ensuring audit quality for financial audits. Their arrangements vary but are all consistent with ISQC1. Further information about their audit quality arrangements is available in their Transparency reports.



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# Inputs

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This section of the report explains how the inputs to an audit, such as knowledgeable and experienced staff, audit methodologies and the arrangements for ensuring compliance with ethical standards put in place by auditors contribute to the delivery of audit quality.

## Values, Ethics and Attitudes

### Independence

Scottish public sector bodies do not appoint their own auditors. The independent appointment of auditors is a unique feature of public sector audit and is an important safeguard that helps to ensure that the auditor is free from any potential conflict of interest or other pressure which may compromise their judgement. The Auditor General and Accounts Commission appoint auditors to carry out the statutory financial audits of Scottish public sector bodies. The appointed auditors include Audit Scotland staff and some of the major UK audit firms. Audit Scotland's Performance Audit and Best Value staff carry out performance audits and work with financial auditors in auditing Best Value. Auditors are required to apply their professional expertise to conduct their audits and report their findings in public.

### Ethics

Audit Scotland has a rigorous process to ensure that all auditors comply with the Financial Reporting Council's Ethical Standard to avoid any actual or perceived conflicts of interest. The AAT works with Audit Scotland's Ethics Partner to evaluate potential conflicts of interest when making recommendations for audit appointments.

All Audit Scotland staff complete an annual Fit and Proper form, and appointed firms have equivalent local arrangements for their employees working on public sector audits. Staff are personally responsible for declaring any potential conflicts of interests.

### Non-audit services

Auditors may undertake some non-audit services for the bodies they audit. Audit Scotland has issued a policy statement on behalf of the Auditor General and Accounts Commission explaining what non-audit work is permissible and requiring auditors to explain how any proposed work complies with the Financial Reporting Council's Ethical Standard and the Code, together with an explanation how their independence will be safeguarded. The AAT considers all applications to carry out non-audit services and only approves work that clearly complies with the Ethical Standard and, where necessary, consulting Audit Scotland's Ethics Partner on the decision. In 2016/17 auditors carried out permitted non-audit work to a value of £611k (3% of total fees) without compromising their independence.

## Knowledge, Experience and Time

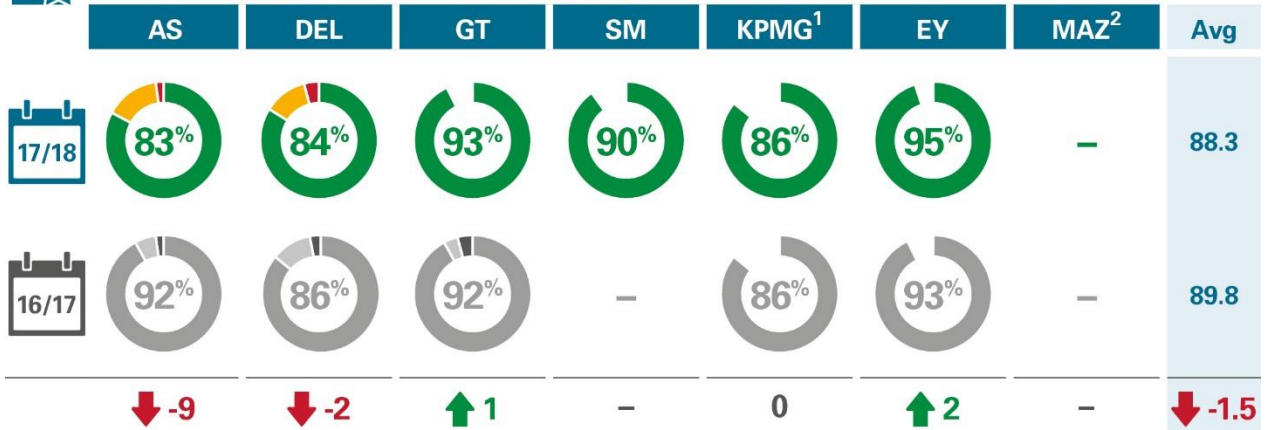
People are the most important assets in an audit. Having the right staff, allocating the right time to audits and providing the right training and knowledge are critical to delivering high-quality audit work. The quality of the staff inputs to audits are demonstrated through staff surveys, qualifications, training and application of technical guidance.

## Staff surveys

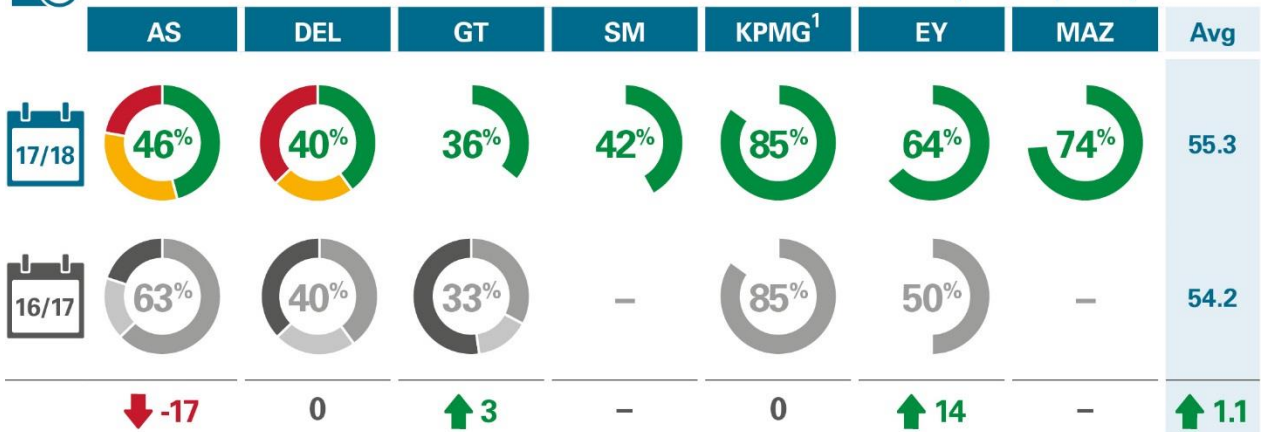
Audit Scotland and appointed firms conduct regular surveys to provide an insight into staff views on how well they are supported to provide high-quality audit work. The information presented by the appointed firms is representative of the public sector audit work carried out in Scotland. This is only the second year for which this data is available.



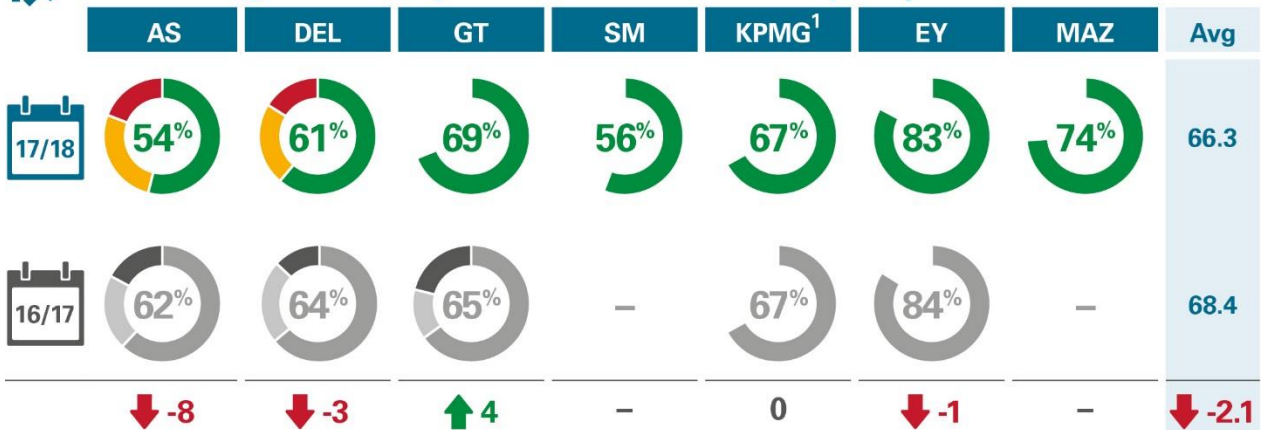
### I am encouraged to perform a high quality audit



### The time and resources available to me enables the delivery of a quality audit



### The training and development I receive enables a quality audit



#### Notes:

1. The 2016/17 and 2017/18 data shown here are from the same survey.

2. Mazars undertook a staff Engagement Survey during 2017/18 which did not ask any questions directly relating to the performance of a high quality audit. The scores for other indicators have been taken from comparable measures in the Engagement Survey.

The emerging results show that there is a strong culture of support for performing high-quality audit across all audit providers, although the percentage of staff indicating that they are encouraged to perform a high-quality audit has declined slightly. The responses on the amount of time available to auditors across the profession show considerable variation between providers although there is little change in the year and auditors remain broadly positive about the adequacy of training.

This information enables monitoring of trends over time and allows providers to take account of the findings in developing their HR strategies.

### Qualifications

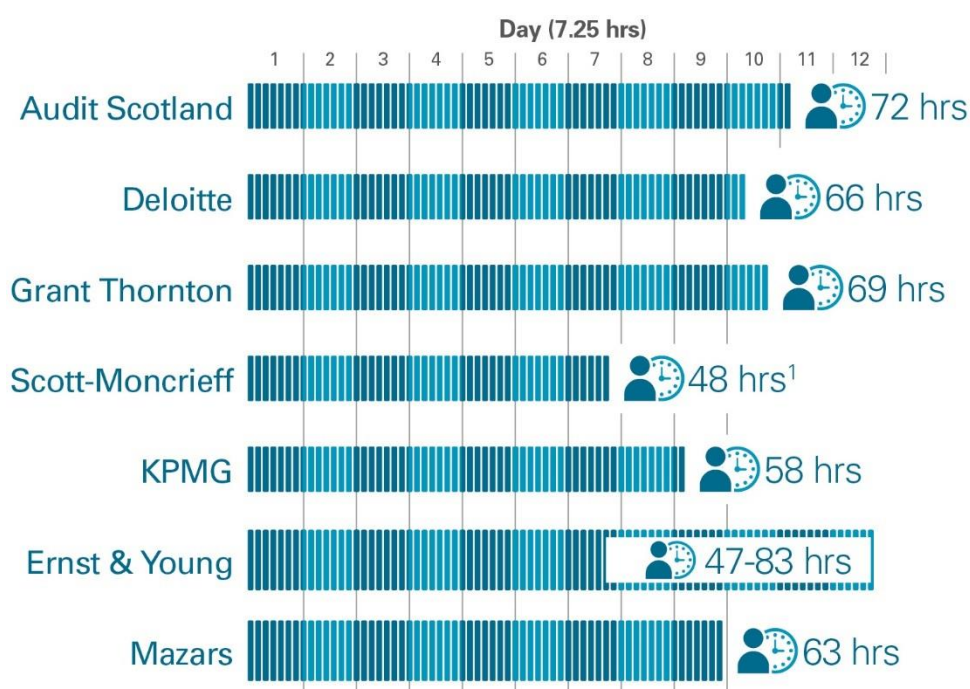
Audit work is carried out by appropriately trained and qualified individuals. Appointed firms have between 95% and 100% of their staff either qualified or in training. Audit Scotland staff are appropriately qualified with 95% of staff working in financial audit either CCAB (Consultative Committee of Accountancy Bodies) or Chartered Institute of Management Accountants qualified or in training for a CCAB qualification. A further 5% have other qualifications in areas such as accounting or IT.

Performance auditors and Best Value auditors in Audit Scotland have a variety of audit and research-related qualifications, including post graduate qualifications, all of which go towards supporting the delivery of high-quality audit work. Within the Performance Audit and Best Value group 25% of staff are also either CCAB qualified or in training for a CCAB qualification, which supports Audit Scotland's flexible 'One organisation' working.

### Training

Audit Scotland runs one of the largest public sector accountancy training schemes in Scotland, with 42 trainees and staff working towards ICAS qualifications.

The evidence shows that all auditors recognise the importance of training their staff. The average number of hours that staff receive in a year are shown in the table below. This figure excludes trainees.



Note: 1 Scott Moncrieff's total excludes wider Continuous Professional Development undertaken by staff.

The amount of time spent on staff training varies between providers. This variation arises from the different ways in which training is organised and recorded. Nevertheless, the data shows that considerable investment is being made in staff training with an overall average of 63 hours per member of staff.

The professional institutes, of which all qualified auditors are members, have Continuous Professional Development requirements which they monitor. This provides further assurance that auditors are undertaking adequate training to maintain their professional competence.

### Technical guidance

Audit Scotland's Professional Support team provides guidance and advice on technical accounting and auditing issues to all auditors to inform their professional judgement and promote a consistent approach. The Professional Support team also provides bulletins and updates on technical developments and emerging risks to auditors and audited bodies, promotes good practice in financial reporting, produces guidance on wider scope subjects, and ensures the Auditor General and the Account Commission are updated on technical developments where appropriate. Appointed firms supplement this with their own technical guidance and advice to staff.



The Professional Support team has issued guidance to help financial auditors and audited bodies reduce the number of capital accounting errors in future in response to a thematic review of Prior Period Errors by the AAT. The thematic review was based on prior period errors identified by financial auditors and reported in 2016/17 financial statements of public sector bodies in Scotland. The total value of these errors was £768m, made up of 31 individual errors across 18 audited bodies. 90% of these errors were in capital accounting, primarily in local government. All the identified errors were reported in the Annual Audit Reports delivered to the individual bodies and corrected in their 2016/17 statements. The review nevertheless highlighted the need for increased technical guidance and focus on capital accounting by both audited bodies and auditors.

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### Professional Support team

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### Audit process and quality control arrangements

The *Code of Audit Practice* applies to the audits covered by this report and is the key document in defining the scope of the audit of public sector bodies in Scotland. The Code places specific expectations on auditors, in particular, the wider scope of public audit. This is most notable in the requirements to provide conclusions on the audit dimensions (financial sustainability, financial management, value for money, and governance and transparency alongside Best Value). The wider audit reporting requirements in the Scottish public sector differentiates this work from private sector audit, and requires greater judgement from the auditor. It also puts more useful information in the public domain about the audit process and about performance of the bodies being audited.

## Organisation-wide audit quality arrangements

Audit Scotland and the appointed firms are responsible for their own organisation-wide arrangements for quality control in accordance with ISQC1 and professional guidance. These arrangements focus on making continuous improvements to audit work by implementing a cycle of reviews, understanding why errors are made and sharing good practice.

Effective audit arrangements share some critical features. The specific arrangements vary slightly between financial, performance and Best Value auditing, but the key overarching components are explained below.

### Manuals and methodologies

All staff must comply with relevant manuals and methodologies and record all work on the appropriate corporate documentation system. Manuals and methodologies set out how to conduct the audit to ensure high compliance with auditing standards. These are regularly reviewed and updated to ensure they reflect changes in standards and continue to meet business requirements.

Financial audits, whether undertaken by Audit Scotland or appointed firms, share certain common features to ensure audit quality. They are designed to comply with International Standards on Auditing (ISA) and the International Standard on Quality Control (ISQC1) and the Code.

Performance audits, auditing Best Value, statutory reports (S102 or S22), sector overview reports, and reports in the “How councils work” series share a common set of audit quality arrangements. These audits are designed to comply with Audit Scotland’s Audit Management Framework or Auditing Best Value Manual rather than ISAs. The Audit Management Framework draws on International Organisation of Supreme Audit Institutions standards and covers each key stage of an audit from project selection, audit design, fieldwork and reporting through to post-audit review and impact assessment.

### Review of work

More experienced members of the audit team review all the audit work of less experienced staff. This review process helps ensure that audit work achieves its objectives, judgements are appropriate, and work complies with the audit methodology and auditing standards. This type of review extends to all types of work including financial, performance and Best Value auditing. Reviews provide an opportunity to identify and correct any errors.

The Auditor General, the Accounts Commission and the Controller of Audit also play a critical role in assuring the quality of performance audits and auditing Best Value. They are involved at the planning and reporting stages of audits to ensure that the audits are high quality and meet their needs.

### Hot reviews

All auditors carry out a programme of hot reviews before the audit opinion is signed or the report issued. Audit providers apply a variety of approaches using different criteria to select which audits are subject to hot review. Overall judgements, conclusions and the wording of the independent auditor’s report are reviewed at a proportion of financial audits based on audit size, risk or likelihood of a modified opinion. Auditors’ approaches to specific issues are reviewed across the population where a specific matter is considered to be high risk or to ensure that training has been successfully reflected in audit work.

Hot reviews are used to provide assurance that the judgements in the reports are appropriate and are supported by appropriate audit evidence. Auditors then carry out root cause analysis to better understand what led to these errors. This helps to identify what changes will best be able to prevent any recurrence of the errors and contributes to shared learning and ownership of audit quality.

## Cold reviews

Cold reviews are conducted after the completion of the audit and provide a higher level of assurance than hot reviews. They differ from hot reviews in that they cannot change the work in the event of an error. Cold reviews go into greater depth than hot reviews.

Audit Scotland commissioned ICAS to carry out a fully independent programme of cold reviews. The programme includes samples of 2016/17 financial audits carried out by Audit Scotland auditors and firms, and on performance audits and Best Value assurance reports published in 2017. These independently conducted reviews provide the highest level assurance on audit quality.

Assurance is also drawn from cold reviews carried out by audit providers where senior and appropriately experienced colleagues that have not been involved in the audits carry out a sample of reviews after audits have reported. The samples of financial audits reviewed ensure that all auditors that sign an opinion are reviewed at least once in a three-year cycle and cover all sectors and sizes of audit. The results are reported back to the teams that conducted the audit. The results also help to identify wider training needs and where audit manuals and methodologies can be improved.



The independence of the reviews is further strengthened within Audit Scotland by having reciprocal arrangements with other members of the UK public audit forum and by firms using staff from other UK offices. In the case of the appointed firms, the scoring from quality control reviews forms a part of the performance assessment of the engagement lead.



# Outputs

## Audit Quality Indicators

This section summarises the results of the audit quality review work carried out in accordance with the Audit Quality Framework. Many of the reported indicators included in this section are common to those agreed by the Professional Reputation Group (a forum for the six largest firms: BDO, Deloitte, EY, Grant Thornton, KPMG and PwC). Where possible the Financial Reporting Council grading system has been applied. The Financial Reporting Council has set an expectation that 90% of all FTSE350 audits reviewed will achieve a score of Good or Limited Improvements Required (categories 1 and 2A) by 2019. The Financial Reporting Council recognised in their [thematic report on Audit Culture](#) that they cannot be confident that the 2019 target will be achieved.

Score	Standard	Description
1	 <b>Good</b>	No areas for improvement that warrant inclusion in the quality assurance report.
2a	 <b>Limited improvements required</b>	Limited concerns in a small number of areas identified. In such circumstances the auditor would adjust the audit approach in subsequent years' audits to address the issues raised.
2b	 <b>Improvements required</b>	A number of matters are reported but these are assessed as neither individually or collectively significant. In such circumstances it is expected that the auditor would consider whether any remedial action is required in respect of the audit inspected and to amend procedures for subsequent audits.
3	 <b>Significant improvements required</b>	<p>The QA reviewer has significant concerns in relation to the sufficiency or quality of evidence, or the appropriateness of key judgements, or the implications of other matters that are considered to be individually or collectively significant. In such circumstances some remedial action may be requested to address the issues identified and to confirm that the audit opinion remained appropriate.</p> <p>In such circumstances some remedial action may be requested to address the issues identified and to confirm that the audit opinion remained appropriate.</p>

A detailed analysis of scores by audit provider is not included in this report. Although there is evidence of audit quality in respect of each provider, individually they have not all been subject to the same level of review in the first year of the current Framework. The programme of reviews under the Framework extends to all providers over the current appointment period and this will enable comparative performance to be reviewed.

## Quality monitoring

### Cold reviews

#### Independent external reviews

Independent external assurance offers the highest level of assurance to stakeholders. ICAS reviewed two financial audits carried out by Audit Scotland and one by Deloitte, one performance audit and one Best Value assurance report. Each of the financial audits achieved a 2A score which is a very strong result. Indicative scores were provided for performance audit and Best Value of 2B and 3 respectively when assessed against ISAs. ICAS concerns were mainly about ISA compliance, and identified this in particular as an area for future focus in performance and Best Value work.

ICAS provided the following comments on the audits that they reviewed:

#### ICAS provided the following comments on the audits that they reviewed:



“The financial statement audits reviewed were generally of an acceptable standard. Whilst a small number of evidence points were identified, the majority of issues were of a documentation nature, and a number of positive areas were identified in each engagement file reviewed, particularly at the planning and completion stages.

The Audit Scotland financial statement engagement files would benefit from an increase in the documented justification of the audit approach taken and the sampling methodology; and consideration as to the documentation of the wider scope of audit, including more clarity on the audit approach to the four dimensions.

With regards the Performance audit, no significant issues were identified with regards compliance with the Audit Scotland Audit Management Framework.

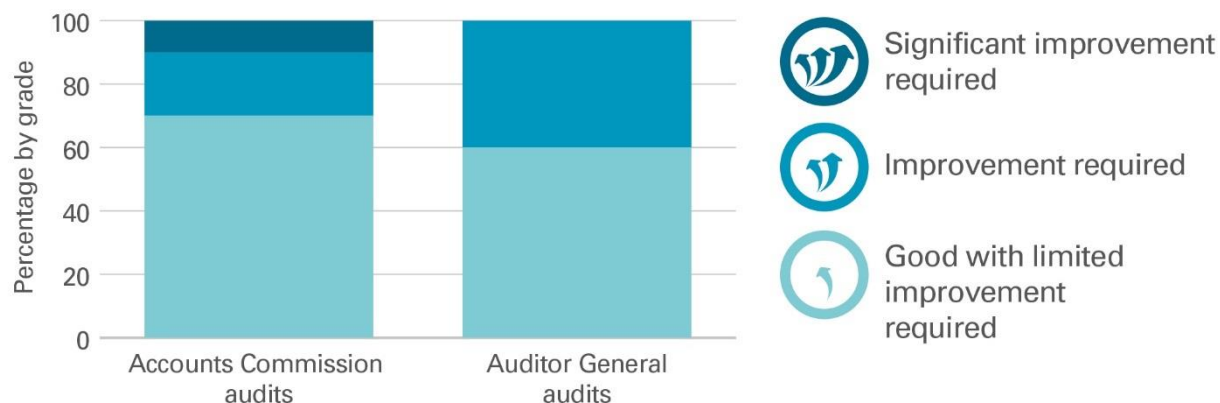
The extent of work performed on the Best Value audit was difficult to determine, with a number of root causes, including an under estimation of the training required to use the audit documentation system, resulting in the document retention system being used by some members of the team; this being the first year of a new Best Value process; and the team experienced an unusual level of sickness and unplanned absence.

With regards Performance audits and Best Value audits, some further consideration needs to be given as to appropriateness of International Standards on Auditing and Financial Reporting Council grading being applied, although it is still appropriate that a full audit trail of each engagement should be apparent on any audit engagement. As such, a main focus going forward should be the Audit Scotland methodology and approach to such engagements, particularly to document the full nature, timing and extent of work performed; the review process; and, overall, the progress of the audit”

### Internal reviews conducted by Audit Scotland and appointed firms

Auditors carried out 20 internal cold reviews covering 8% of 2016/17 financial audits (12 reviews covering 7% of 2015/16 audits). This is the first time that all audit work covering all auditors has been reported under the Financial Reporting Council's grading to provide comparability and more meaningful assurance.

### Results of internal cold reviews



The results of the quality monitoring activity show that 68% of audits were assessed as good or limited improvements required. This is a similar proportion to the 73% reported by the Financial Reporting Council (described below) for their reviews of private sector work by the firms that carry out public sector work in Scotland. The correct audit opinion was given for all audits reviewed. This provides assurance that overall the audit work carried out on 2016/17 financial audits was of a high standard, supported key judgements and resulted in the correct audit opinions being issued.

The most frequent areas for improvement relate to failures to fully document the audit process required by ISA 230 (Audit Documentation) and the need to provide a clear trail between the evidence recorded in the audit files and the conclusions reached. This applies equally to financial, wider dimension and Best Value auditing.

Auditors carried out two internal cold reviews covering 20% of performance audits published in 2017/18. These were also scored using the Financial Reporting Council's grading to provide comparability and more meaningful assurance. One report was assessed as a 2A and one as a 2B.

Auditors are putting arrangements in place to address the findings from cold reviews. The AAT will monitor how well the new arrangements improve audit quality.

### Financial Reporting Council reviews

The Financial Reporting Council is responsible for monitoring the audit work of UK firms that audit Public Interest Entities, and certain other UK entities. This broadly means firms that are listed on the stock exchange. The monitoring work assesses a sample of completed audits and the policies and procedures supporting audit quality.

The [Financial Reporting Council](#) publishes firm specific reports annually on the quality of financial audits for the six largest firms, and less frequently for other big firms (such as Mazars). The sample of audits inspected does not include any Scottish public sector bodies therefore it does not provide direct assurance to the Auditor General and Accounts Commission. The reports, however, still provide valuable assurance about the overall policies and procedures which are broadly the same for firms between private sector and public sector work.

The most recent inspection reports were published in June 2017. The chart below shows the outcome of firms' inspections for their private sector work on 2015/16 audits and the previous three years. There is a generally improving trend over the last four years showing that audit quality is improving. All firms explain their plans to improve audit quality in their firm specific reports.



### Other external reviews and investigations

No appointed firms were subject to external investigations, e.g. by regulators, in relation to their public sector work. No Audit Scotland work or staff were subject to any external investigations.

### Hot reviews

Audit Scotland teams conducted eight reviews covering 6% of 2016/17 financial audits (compared to seven reviews covering 6% of 2015/16 audits) all of which were satisfactorily concluded. These hot reviews were designed to meet the scope of Engagement Quality Control Reviews (EQCR) as set out in ISQC1. Deloitte and Mazars conducted hot reviews on all their audits. KPMG conducted an EQCR scope review on Aberdeen City Council because it is a Public Interest Entity. The other appointed firms did not conduct any EQCR scope reviews, although Grant Thornton reviewed two 2016/17 audits against their audit quality measures.

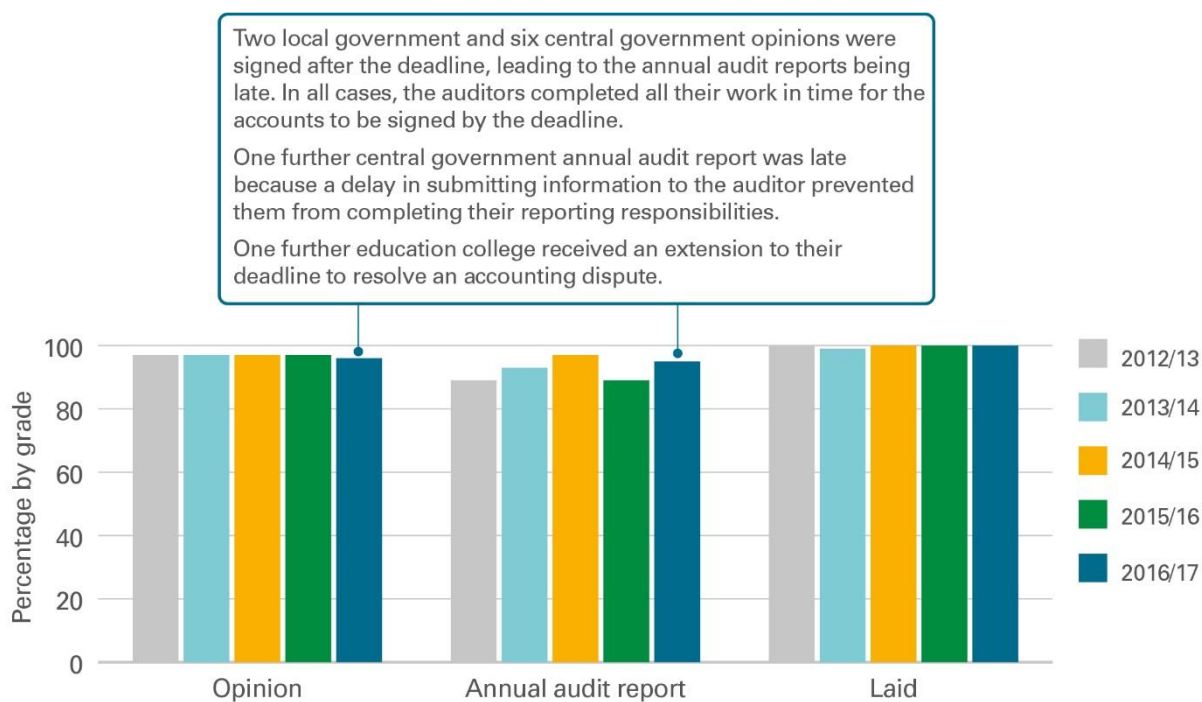
Performance Audit and Best Value staff not involved in the work reviewed all 10 performance audits and six Best Value audits published in 2017/18. The reviews helped to shape the final reports and confirmed that the judgements were appropriate and supported by evidence.

## Reporting

### Timeliness of Financial audit work on 2016/17 accounts

Audit Scotland sets deadlines for auditors to ensure that their financial audits are completed in a timely manner. The deadlines vary by sector. Audit opinions and annual audit report deadlines are 30 June for health, 30 September for local government, 31 October for central government and 31 December for further education. The accounts of all bodies other than local government must be laid in the Scottish Parliament. Legislation requires the accounts to be laid within nine months of the financial year end. This is 31 December for health and central government and 30 April for further education.

Audit Scotland expects auditors to do all they can to meet the deadlines but recognises that in some circumstances, events beyond their control can cause the deadlines to be missed. Auditors' performance in meeting the deadlines for 2016/17 audits with the previous four years for context is set out below.



### Modification of audit opinions

Modified audit opinions are issued where an auditor concludes that the accounts contain material misstatements, where significant expenditure has been incurred in breach of rules, or where reporting requirements have not been met.

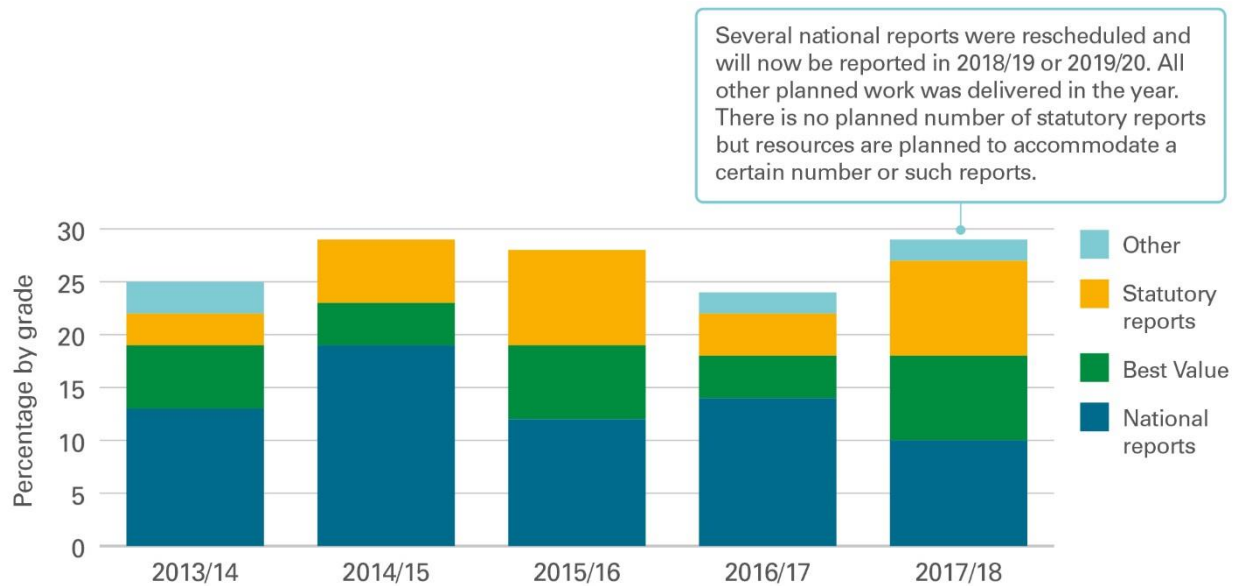
There were no modified audit opinions in 2016/17 (two modified opinions in 2015/16). There were four instances where the auditor reported by exception (six in 2015/16). These were all where local government significant trading operations failed to achieve the statutory objective to break even over a three-year period.

### Publication of performance audit and other reports

The number of performance audit and other reports fluctuates over time. The Auditor General and Accounts Commission have a five-year rolling work programme that covers a range of public sector bodies and services.

The Auditor General writes statutory reports under Section 22 of the Public Finance and Accountability (Scotland) Act 2000 for laying in parliament and the Controller of Audit writes statutory reports under Section 102 of the Local Government (Scotland) Act 1973 to the Accounts Commission. The Auditor General and the Controller of Audit may prepare reports where they identify matters that require reporting, and the Accounts Commission may require the Controller of Audit to report on specific matters.

Audit Scotland’s performance in delivering national performance audits, Best Value reports, statutory reports and other reports during 2017/18 with the previous four years for context is set out below.



Progress on delivery of the work programme is routinely reported to the Accounts Commission's Performance Audit Committee and the Auditor General throughout the year. Any changes to planned publication dates are agreed with the Auditor General and/or the Accounts Commission's Performance Audit Committee.

### Audit Reports and adding value

The Code recognises the increasingly high expectations the public has about the role of audit in the stewardship of public funds. It defines the wider scope of public audit as going beyond the financial statements to include work that contributes to audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability. In the local government sector, the audit of Best Value is central to auditor reporting on the audit dimensions.

The AAT reviewed a sample of annual audit reports to assess how effectively they were complying with the Code including this new area of audit judgement. The review found that there was a good level of compliance. Auditors have embraced the Code requirements around reporting on the wider audit dimensions of public audit in Scotland. The clearest conclusions were firmly embedded in the audit work and evidence gathered in the year.

Council auditors reported appropriately on their Best Value work undertaken in the year though there is room for improvement in Best Value reporting at integration joint boards. The review also identified that some improvements are required to ensure all auditors make the mandatory ethical and independence disclosures in annual audit reports. There is scope for all auditors to be clearer in demonstrating how they are adding value through the audit.

The action taken by auditors in response to these findings alongside recent guidance issued to auditors by the Professional Support team will support improvements in the quality of audit reporting.



**Financial management**

The [Reshaping care for older people](#) report recommendations led to action by the Scottish Government to improve the range and quality of cost and activity data on health and care services for older people (specifically community-based services where we had identified key gaps).

The [Procurement in councils](#) report recommendations contributed to improved procurement performance in 23 out of 25 councils assessed and improved procurement performance by councils in all eight Procurement Capability Assessment (PCA) areas.



**Value for money**

The auditor of [NHS Grampian](#) used peer group KPIs to highlight poor comparative performance to the board, including focussed analysis of four target areas. The auditor recognised the challenge of meeting agreed priority government performance targets and while also achieving financial break-even.



**Governance and transparency**

Many Audit Scotland auditors highlighted increasing public expectations for greater openness and transparency in public business. This was based on a wide-based understanding of governance in the public sector in Scotland and evidence of a shift in expectations. Some organisations such as [Visit Scotland](#) have already responded by reviewing what they make available publicly following discussions with their auditors.



**Financial sustainability**

The auditor of [NHS Lanarkshire](#) presented the board with a report on delayed discharges after identifying this as a significant risk to the board. The auditor identified a number of areas where improvements could be made but emphasised that the board can only reduce delayed discharges by working closely with the North and South Lanarkshire IJBs.

The auditor of [NHS Ayrshire & Arran](#) provided case studies and recommended support for the board when making cost reduction decisions. Providing this sort of information is a good example of how auditors can help add value in their work.



**Best Value**

The auditor of [West Lothian Council](#) set out their 5 year Best Value audit plan to explain how they would meet their reporting responsibility in support of the council's Best Value duty.

## Stakeholder views on audit work

The AAT considered evidence of stakeholder views on the quality of audit work through direct use of surveys, other feedback mechanisms including consultation and engagement carried out directly by members of the Accounts Commission, and survey work carried out by third party consultants on behalf of the Auditor General and Controller of Audit.

The evidence showed that the areas where auditors added value and achieved impact were in the clarity of reports, attending Audit Committees and providing the opportunity for members to ask questions. Respondents commented positively about how auditors' reporting on the wider audit dimensions helped public sector bodies to focus on key issues and hold officers to account. Feedback was also helpful in identifying areas where auditors can work with stakeholders to make further improvements.

A detailed analysis of the impact of the new approach to Best Value auditing was undertaken in 2017/18. Overall the results provided positive evidence of stakeholder satisfaction with the objectives of the new integrated approach to Best Value Assurance Reports, the time and resources invested in the process and outcomes in terms of focussing on the areas for improvement.

The Performance Audit impact evaluation and stakeholder satisfaction assessments undertaken during the year, all of which elicited stakeholder views, showed positive support for performance work and the value it adds.



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# Areas for improvement and future focus

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The introduction of the new Audit Quality Framework has provided strong evidence to the Auditor General and to the Accounts Commission on the quality in 2016/17 financial and Best Value auditing and the 2017/18 performance audits. The evidence is wider and deeper than previously available and comprises an assessment of compliance with the highest professional standards and the achievement of impact and other qualitative measures.

Work carried out within the Audit Quality Framework has highlighted areas where further improvement may be possible to enable Audit Scotland to continue the drive towards world class audit. The evidence will be used in discussion with all audit providers to focus on areas for improvement including:

- raising the standard of audit documentation where necessary
- encouraging auditors to be clearer in demonstrating how they are adding value
- ensuring mandatory ethical and independence disclosures are made in annual audit reports
- increased focus on capital accounting by both auditors and audited bodies.

The AAT will continue to develop its activities to provide appropriate assurance to the Auditor General and Accounts Commission. Following the first year of applying the Audit Quality Framework there is an opportunity now to take stock of the impact achieved and consider areas for further development including:

- considering the extent to which performance and Best Value work should comply with International Standards on Auditing (ISAs)
- extending appropriate assurances on the quality of Best Value auditing in the local government sector
- the range of KPIs and trend data available to help track ongoing performance
- a more co-ordinated and consistent approach to acquiring stakeholder feedback.

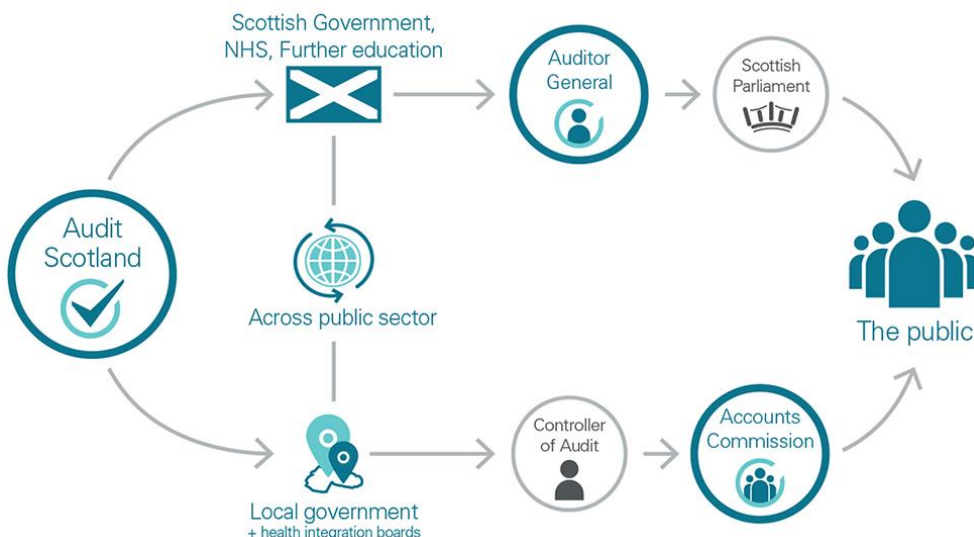
# Appendix

## How Audit Scotland is structured

Audit Scotland is a body established by the Public Finance and Accountability (Scotland) Act 2000 to provide the Auditor General and the Accounts Commission with the services they need.

Audit Scotland, the Auditor General and the Accounts Commission work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of a non-executive board chair the Auditor General, the chair of the Accounts Commission, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament. The Audit Scotland Board is responsible for all Audit Scotland's functions. It exercises its powers and authorities through its Scheme of Delegation.



## Appointments and Assurance Team

This report has been prepared by the Appointments and Assurance Team who are independent of audit delivery. The team provides assurances across all audit work and providers on audit quality to the Auditor General and the Accounts Commission. The team is led by an Assistant Director who reports directly to the Chief Operating Officer.

The board members during 2017/18 were as follows:



**Ian Leitch CBE**  
Chair of the board



**Caroline Gardner**  
Auditor General and Accountable Officer for Audit Scotland



**Dr Graham Sharp**  
Chair of the Accounts Commission (from November 2017)<sup>1</sup>



**Heather Logan**  
Independent non-executive member



**Professor Russel Griggs OBE**  
Independent non-executive member

Note: 1. Ronnie Hinds became acting chair of the Accounts Commission and joined the board in March 2017. Graham Sharp was appointed chair of the Accounts Commission on 1 November 2017.

**Ian Leitch CBE** was an assistant chief executive at the Scottish Parliament before his retirement, and before that was in local government. Ian joined the board on 1 April 2014 and became chair in October 2015.

**Caroline Gardner** is the Auditor General and the Accountable Officer for Audit Scotland. She was appointed by the Crown for a single fixed-term of eight years from 1 July 2012.

**Dr Graham Sharp** is Chair of the Accounts Commission. After a career in the private sector, principally in financial services, he has experience in the third sector and public sector experience as a member of the Competition and Markets Authority, a Gambling Commissioner and over eight years serving on the Accounts Commission.

**Ronnie Hinds** was the acting chair of the Accounts Commission from 9 March 2017 to 31 October 2017. He is a former chief executive of Fife Council, and chairs the Local Government Boundary Commission for Scotland.

**Heather Logan** was a member of the Scottish Government's audit and risk committee and chair of the corporate services audit and risk committee. Heather joined the board in October 2015 and is currently chair of the Audit Committee.

**Professor Russel Griggs OBE** has had several non-executive positions in the private, public and third sector. Russel joined the board in October 2015.

The board has two standing committees:

The Audit Committee oversees the arrangements for internal control, risk and corporate governance, internal and external audit, the annual accounts and the Standing Orders, Financial Regulations and Scheme of Delegation.

The Remuneration and Human Resources Committee oversees the arrangements for salaries and terms and conditions of staff and other HR matters.

Audit Scotland's governance arrangements provide effective governance while preserving the independence of the Auditor General and the Accounts Commission in their statutory roles.

All audit judgements are made independently by the Auditor General, the Accounts Commission, the Controller of Audit or appointed auditors.

A management team oversees Audit Scotland's day-to-day operations.

The members at 31 March 2018 were as follows:



**Caroline Gardner**  
Auditor General  
and Accountable  
Officer for Audit  
Scotland



**Diane McGiffen**  
Chief Operating  
Officer



**Fraser McKinlay**  
Director of  
Performance  
Audit and Best  
Value and  
Controller of Audit



**Fiona Kordiak**  
Director of Audit  
Services

**Diane McGiffen**, Chief Operating Officer, chairs management team meetings and is responsible for internal operations and business performance.

**Fraser McKinlay**, Director of Performance Audit and Best Value and Controller of Audit, manages a team that is responsible for carrying out performance audits and Best Value auditing.

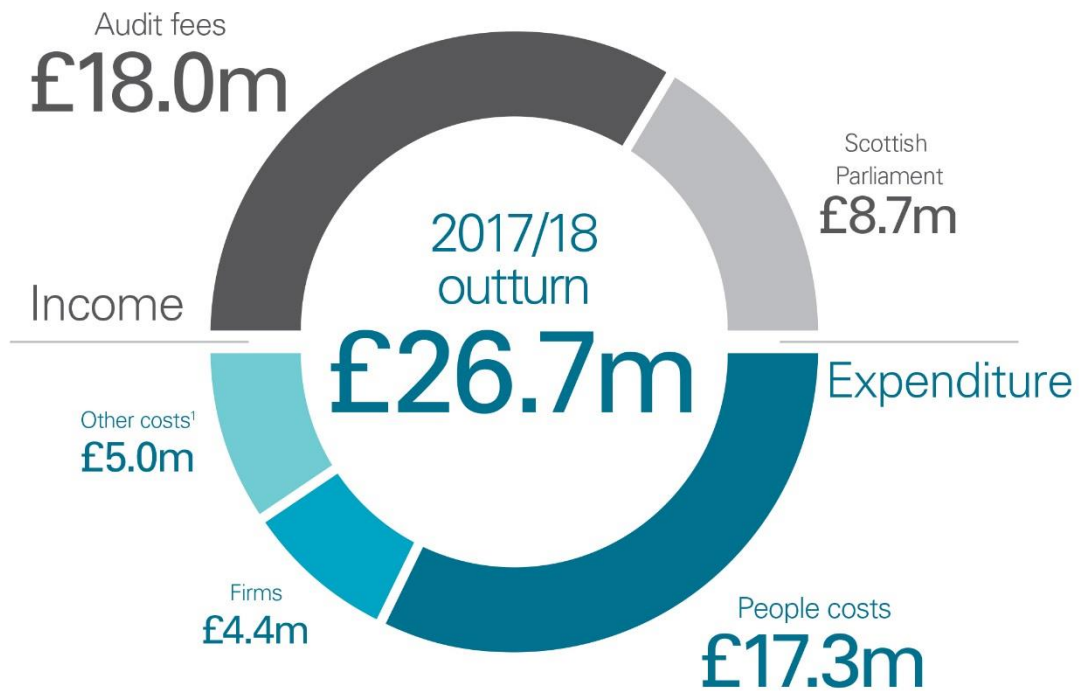
**Fiona Kordiak**, Director of Audit Services, is responsible for the Audit Scotland financial audit services provided to the health service, further education, central and local government. She acts as Audit Scotland's Ethics Partner.

## Audit Scotland's finances

Audit Scotland's costs are met from a combination of audit charges to public bodies and funding from the Scottish Parliament through the annual Budget Act. Audit fees are set to recover the costs of local audit work and, where appropriate, a contribution to other audit and support costs.

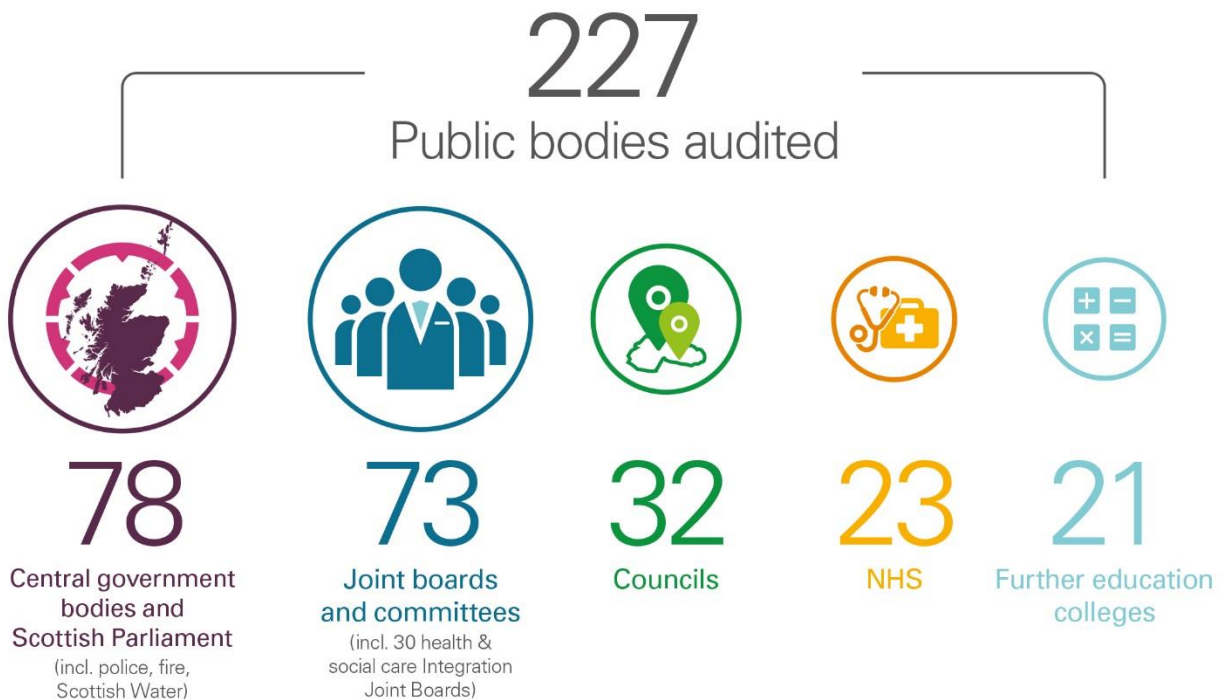
Audit Scotland's spending and use of resources are examined by the SCPA. This is a statutory body comprising five MSPs that reports to Parliament and appoints external auditors for Audit Scotland.

## Income and expenditure 2017/18 (£ millions)



Note: 1. Other costs include property, digital services, travel and subsistence, capital expenditure, and depreciation.

## Audited bodies



Public sector auditors in Scotland audited the 2016/17 accounts of 226 [public organisations](#) in 2017/18, including the Scottish Government, the NHS in Scotland and local authorities. These organisations spend over £40 billion of public money every year. The Auditor General appoints auditors for central government, NHS and further education college audits, while the Accounts Commission appoints auditors for local government audits, including integration Joint Boards.

# Audit quality

## Annual report 2017/18

This report is available in PDF and RTF formats, along with a podcast summary at:

[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) 

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500

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ISBN 978 1 911494 64 5