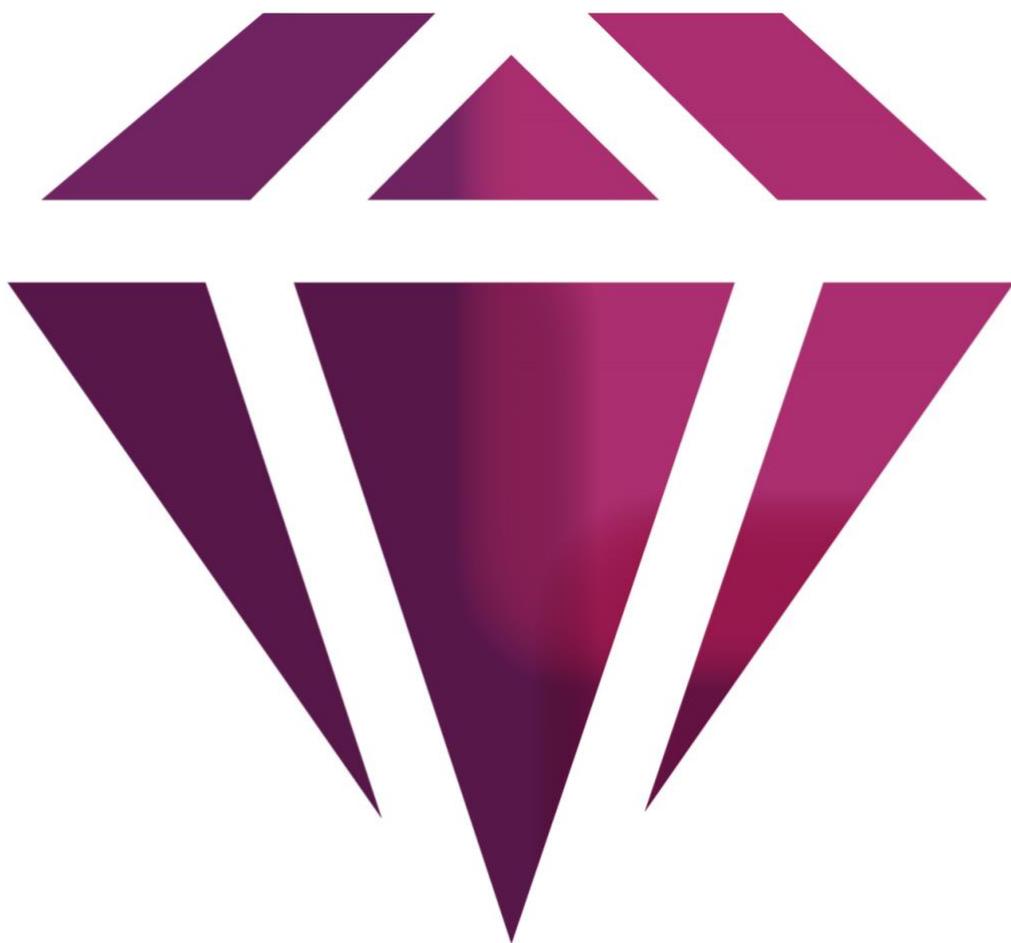


# Quality of public audit in Scotland

Annual report 2022/23



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## **Audit Quality and Appointments**

The team responsible for this report consisted of Owen Smith, John Gilchrist and Parminder Singh, under the direction of Elaine Boyd.

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# 1. Key messages

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## Operating environment

1. 2021/22 was the final year of the six-year audit appointments which began in 2016/17. These appointments were extended by one year to reflect the uncertainty and impact of the pandemic on audited bodies and auditors. During 2022, the Scottish Government delayed the accounting and auditing deadlines for a third year, for NHS and local government bodies, to support recovery from the pandemic.
2. There is evidence, particularly from the audit delivery performance results, that auditors and audited bodies have not fully recovered from the pandemic and are assessing and testing new ways of working to support recovery.

## Overall conclusion

**3. The [Audit quality framework](#) (AQF) identifies good practice and areas to improve in audit quality, we note that there are areas of improvement that are recurring and have been carried forward from prior years.** Audit quality is an area of focus in the profession and standards are rising, auditors need to keep in touch with the latest developments and take action to meet expected standards. The framework uses a broad range of tools to assess audit quality including external and internal 'cold' reviews and surveys of audited bodies and auditors. Based on this range of evidence the Audit Quality and Appointments team (AQA) concludes that the quality of audit work is:

- Good in Performance Audit and Best Value (PABV) audit work based on the independent quality reviews conducted by the Institute of Chartered Accounts of England and Wales (ICAEW). Internal quality reviews of performance audit work conducted by Audit Scotland's in-house audit quality team indicate that there is need for all PABV work to consistently comply with the INTOSAI standards.
- Consistently good over the last four years in the accountancy firms carrying out public sector audit work in Scotland based on the independent ICAEW quality reviews and the internal quality reviews of financial audits.
- Good in Audit Scotland's Audit Services Group (ASG) for 2021/22 financial audit work based on the ICAEW's independent quality reviews and Audit Scotland's internal quality reviews. There are some areas where ICAEW have recommended improvements that can be made to ASG's audit methodology and the application of the audit methodology by audit teams. These areas include the need to conduct more audit work where ASG act as the group auditor of audit bodies which have significant component entities; continue to improve ASG's methodology

and documentation around audit sampling to ensure that it complies with best practice in the audit profession; and several improvements required to the audit approach on asset valuations, particularly around demonstrating more challenge around the underlying assumptions. Some of these are recurring issues from prior years and action is required on these to maintain the 80 per cent target in coming years.

**4.** The independent quality reviews provide a clear indication that high quality standards are being achieved in both financial audit work and PABV audit work. Further work is required in some areas to ensure that all the audit work consistently meets the high standards expected by the Auditor General for Scotland and the Accounts Commission.

### **Areas of good practice identified**

**5.** For the first time under the AQF arrangements, a Performance audit was awarded the highest score available by the independent reviewer.

**6.** All performance and best value audits subject to an independent review in the last four years have met the expected quality standard.

**7.** One of the firm's financial audits reviewed was awarded the highest score available by the independent reviewer.

**8.** All the accountancy firms subject to an independent review in the last four years have met the expected quality standard for financial audit.

**9.** Audit Services Group (ASG) have met the expected quality standard for four out of five (80 per cent) of external reviews carried out in 2021/22 (60 per cent in 2020/21). For the 2021/22 audit year nine of the 11 ASG financial audits reviewed, both external and internal, met the expected quality standard (82 per cent). This is a considerable improvement on the 2020/21 results, when 64 per cent met the expected standard. None of the reviews identified any areas which impacted on the audit opinion or were graded as '4' (significant improvements required).

**10.** Overall, the results from the independent quality review of the 2021/22 financial audits are consistent with FRC's reviews of the audit work conducted by the large audit firms in both the private and public sector audits.

**11.** Auditor surveys provide evidence that there continues to be a strong culture of support for performing high-quality audit and that audit organisations are continuing to invest in staff training.

**12.** Stakeholder feedback shows high levels of satisfaction with external audit services provided, the usefulness of the annual audit report, and indicates that the audit work has had impact.

## Areas for improvement

**13. There has been a further significant decline in financial audit delivery performance with only 51 per cent of annual audits being delivered on time (76 per cent in 2020/21).** This widespread decline is concerning. Delayed audit opinions impact on the value of external audit assurance and the ability of public bodies to make decisions based on information that has been subject to independent review. The audit year was compressed in 2021/22 due to the 2020/21 audit year's deadline extension and the comparatively earlier deadlines for NHS and local government sectors in 2021/22. Looking forward, 73 per cent of the 2022/23 audits are already expected to be completed on time. As new audit appointments are started it is important that auditors have plans in place to ensure timely reporting of their work to maximise public accountability and transparency and enable prompt action to be taken by audited bodies.

**14. Audit staff within six of the seven audit providers continue to report concerns that they do not feel they have sufficient time and resources to deliver high quality audit work.** There is evidence that the plans put in place by most audit providers in response to these concerns have improved matters, but a stronger focus and ongoing monitoring is needed to assess the effectiveness of capacity building and efficiency initiatives. There is increasing evidence of a shortage of skilled and qualified audit staff available in the auditing profession and this capacity risk will need to be managed carefully. Audit providers should also consider the efficiency of working practices and how they impact on resource requirements.

**15. ASG staff survey results show a decline to 2017/18 levels for staff being supported to deliver high quality audit work through training and development.** Root cause analysis should be undertaken, and corrective action put in place.

**16. The deadline for audit provider annual quality returns being submitted to AQA was 28 February 2023. The Audit firms provided the required information within the deadline. As with previous years the ASG annual quality return provided in support of the AQF was late and incomplete.** Some of the data provided was also inaccurate and did not provide enough detail to understand explanations for late delivery of audits and areas of added value. ASG must improve the quality and timeliness of management information and arrangements to ensure that the annual quality return information is available to support wider corporate reporting and assurance.

**17. An action plan has been prepared by Audit Scotland in response to the 2022 QPAS report findings and other improvement plans.** There is now an urgent need to prioritise the plan to ensure that work is focussed on the areas that will have a positive impact in continuing to improve audit quality.

## Audit quality conclusion based on the last six-year audit appointments

**18.** The application and reporting of audit quality results under the AQF over the last six years has provided evidence-based assurance to the Auditor General and the Accounts Commission on the quality of audit work carried out on their

behalf and identified areas for improvement and good practice for audit providers.

**19.** ICAS and ICAEW have reviewed all six appointed firms, all Audit Directors in Audit Scotland responsible for financial audits, and all Audit Directors leading on performance audit and Best Value assurance reports over the course of the last six years.

**20.** The primary evidence for providing assurance and identifying improvements over the six years came from the programme of cold reviews carried out by independent reviewers both external and internal. Looking back the reviews carried out were:

- 41 independent cold reviews of financial audits by regulators (ICAS and ICAEW)
- 95 internal cold reviews of financial audits by appointed auditors under their internal quality control arrangements
- 16 independent cold reviews of performance audit and best value reports by regulators (ICAS and ICAEW)
- Eight internal cold reviews of performance audit and best value by Audit Scotland under their internal quality control arrangements
- AQA's direct review of annual audit plans and annual audit reports to assess compliance with the 2016 Code of Audit Practice.

**21.** A suite of audit quality indicators was also applied to quality arrangements to expand the evidence base and provide a balanced picture of relative standing across audit providers. These audit quality indicators included:

- delivery performance
- ethics (non-audit services and ethical standards compliance)
- staff qualifications and training
- audit staff surveys
- stakeholder surveys of key officers in audited bodies.

**22.** Since 2017 AQA has prepared 15 audit quality reports for the Auditor General and the Accounts Commission and made over 40 recommendations to improve audit quality. Auditors have responded well to the impact of the AQF and the quality reports report findings and recommendations. Key areas of note are:

- Performance audit incorporated INTOSAI standards in 2017 following some poor independent review scores at start of AQF review process. All independent reviews have met the expected quality standard since then.

- Audit Scotland has directed resources to establish a new business group that is dedicated to improving audit quality.
- Applying FRC scoring system to cold reviews has helped to measure trends and progress.
- Firms consistently demonstrated good levels of audit quality over the last four years.
- Introduction of independent stakeholder feedback surveys for the first time.

## The role of the AQA team in helping to improve public audit in Scotland

**23.** The AQA team was established in 2016 to manage the AQF on behalf of the Auditor General and the Accounts Commission. The AQA team is operationally independent of auditors and reports directly to Audit Scotland's Chief Operating Officer.

**24.** AQA's role is to provide independent, evidence-based judgements on the quality of the work, including compliance with international auditing standards, delivered by all auditors (Audit Scotland and the six appointed firms). We also ensure that, when required, we give clear actions for improvements required to be made by auditors. AQA also monitors the wider auditing profession in the United Kingdom and beyond, to ensure public auditors in Scotland are complying with best practice from both the private sector and other UK and international public audit bodies. During 2022/23, AQA contacted other UK public sector audit agencies and established a UK public sector audit agency quality group. Although this is at an early stage, we can already see the benefits of working together and the value of benchmarking information.

**25.** We report our findings in public in our annual Quality of Public Audit in Scotland report to provide confidence to the audited bodies that we are holding auditors accountable to the same high standards that we expect of them. This also provides confidence to the citizens of Scotland that they can rely on the quality of public audit in Scotland and the audited financial and non-financial information provided by public bodies in Scotland.

### AQA team action

**26.** Looking forward, the 2022/23 audit year is the first year of the new five year audit appointments that will be carried out under the [2021 Code of Audit Practice](#). AQA is reviewing the effectiveness of the previous AQF with stakeholders and developing a new AQF that meets the needs of the Auditor General for Scotland and the Accounts Commission for the next audit cycle. This follows a successful audit procurement exercise where six firms were secured to carry out the annual audit alongside ASG from 2022/23 to 2026/27.

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## 2. Introduction

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**27.** The [Audit Quality Framework \(AQF\)](#) sets out Audit Scotland's approach to achieving high quality public audit across all audit work and providers. The AQA team prepares this report to provide assurance on audit quality, including compliance with the Financial Reporting Council's [Ethical Standard](#), to the Auditor General for Scotland and the Accounts Commission. AQA does not conduct audit work and is independent from auditors.

**28.** This report summarises AQA's assessment of audit quality conducted on audit work, delivered by Audit Scotland and the six appointed firms, on behalf of the Auditor General for Scotland and the Accounts Commission on the 2021/22 audits. The report provides evidence that auditors have designed and implemented audit quality arrangements to assure the quality of their audit work. The report also highlights areas for further improvement.

### Public audit in Scotland

**29.** The public audit model in Scotland is fundamentally different to the audit of private sector companies. The Auditor General for Scotland and the Accounts Commission set out the principles and themes of public audit in Scotland and how it fits with, and responds to, the public policy environment in Scotland in [Public Audit in Scotland](#). They also set out the scope for public audit for auditors to follow in the [2016 Code of audit practice](#).

**30.** In the private sector, the audit profession remains under scrutiny. After several high-profile cases, where the financial audit process failed to detect and prevent company failures, the auditing profession is trying to regain the trust and confidence of the public. In their response to these corporate and auditing failures, the UK Government confirmed a range of measures to improve governance and auditing arrangements. These include the creation of a new audit regulatory body, the Audit, Reporting and Governance Authority (ARGA), which will take over from the Financial Report Council (FRC). The legislation to create ARGA has been delayed (the UK Government originally planned to pass the legislation in 2023). In the meantime, the FRC has published its [three-year plan for 2023–26](#) which sets out the FRC's plan to transition to ARGA. The FRC has also been charged with improving competition and increasing local government audit market supply in England after agreeing shadow system leader arrangements with government until ARGA is fully established.

**31.** Public audit in Scotland remains well placed to meet the challenges. The mixed market enhances audit quality. Audit delivery utilises skills and resources within Audit Scotland and the six private accountancy firms. Auditor recruitment is challenging across all levels in the profession with limited skills and capacity available. The mixed market model increases resilience in securing required resources to deliver public audit in Scotland.

**32.** The public audit model in Scotland already operates many of the controls proposed by the government reviews to reduce threats to auditor independence. These were integral to the recent procurement and audit appointments project, to secure high-quality auditors for the period 2022/23 to 2026/27. These controls include the:

- independent appointment of auditors by the Auditor General for Scotland and Accounts Commission
- rotation of auditors every five years
- independent fee-setting arrangements
- independent approval procedures for any non-audit services work
- comprehensive Audit Quality Framework.

## Audit Scotland and appointed firms

**33.** Public audit is conducted by Audit Scotland auditors and appointed firms who are subject to an open and rigorous procurement process. Approximately two-thirds of financial and Best Value audit work is carried out by ASG, with the remaining third conducted by appointed firms. The firms appointed are Azets, Deloitte, EY, Grant Thornton, KPMG and Mazars. Performance audit work is carried out by Audit Scotland auditors.

**34.** Each appointed firm has its own arrangements for ensuring audit quality for financial audits. Appointed auditor transparency reports have been reviewed and show good progress is being made to comply with the FRC's International Standard on Quality Management (UK) 1 which is effective for audits carried out after 15 December 2022. Transparency reports are included below for information about their audit quality arrangements.



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## 3. Inputs

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**35.** This section of the report shows how the inputs to an audit provide evidence that the arrangements put in place are contributing to the delivery of audit quality.

**36.** The deadline for audit provider annual quality returns being submitted to AQA was 28 February 2023. The Audit firms provided the required information within the deadline. As with previous years the ASG annual quality return provided in support of the AQF was late and incomplete.

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### Recommendation

ASG must improve the quality and timeliness of management information and arrangements to ensure that the annual quality return information is available to support wider corporate reporting and assurance.

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### Ethics

**37.** All auditors confirmed to their audited bodies and to AQA that they do not have any conflicts of interest. Safeguards are in place to ensure that any potential conflicts are managed through the audit appointments process, annual ethical compliance statements and the controls in place for provision of non-audit services. Cold reviews by internal teams and ICAEW confirmed that all audits complied with the FRC's Ethical Standard to avoid any actual or perceived conflicts of interest.

### Non-audit services

**38.** Auditors may undertake some non-audit services for the bodies they audit. What non-audit work is permissible and how it should be approved is set out within letters of appointments for audit providers.

**39.** Auditors carried out permitted non-audit services to the value of £55k during the 2021/22 audits. This equates to 0.25 per cent of the total fees. This compares to £44k which equated to 0.2 per cent of total fees during 2020/21 audits.

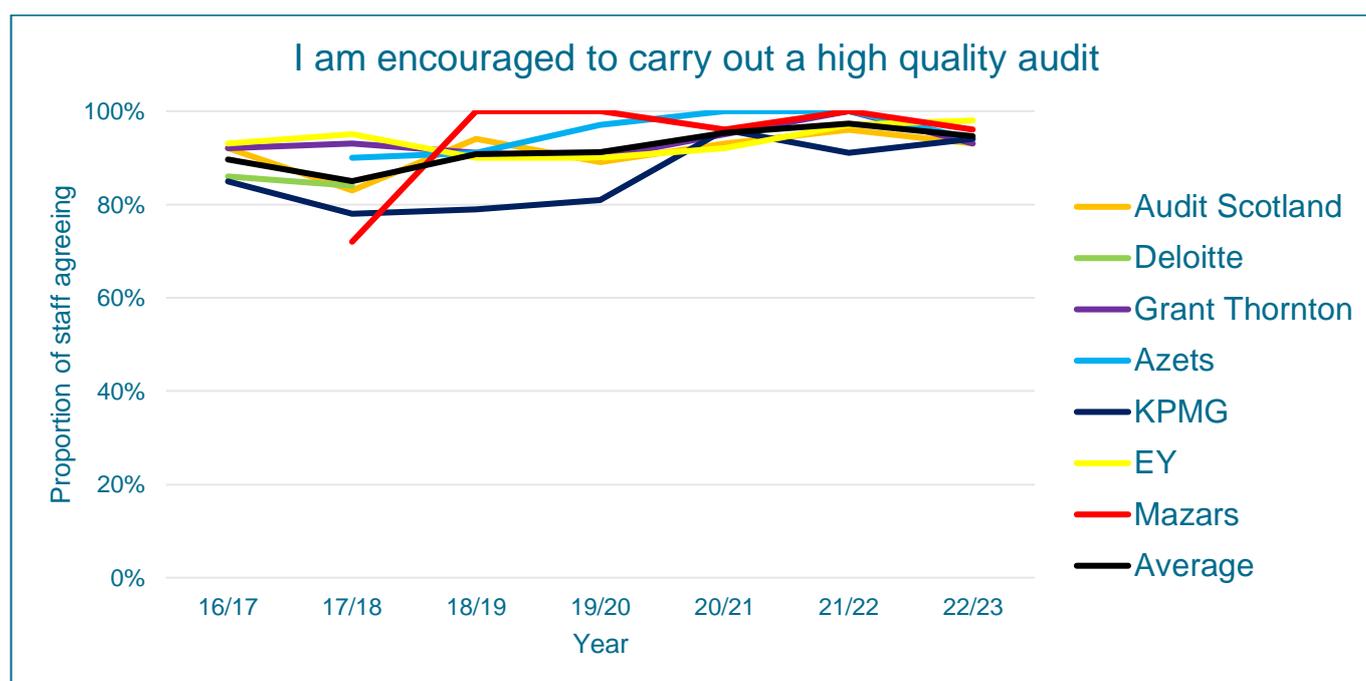
**40.** AQA only approved work that clearly complied with the Ethical Standard and the Code. All audit providers confirmed that they did not carry out any non-audit services without the prior approval of AQA.

## Knowledge, experience and time

**41.** 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. We are aware from our work in the profession and contact with audit providers that there is a shortage of skills and capacity in the audit profession. Audit providers need to align and monitor their workforce and learning and development plans to ensure they have sufficient capacity to deliver their audit work.

**42.** Audit Scotland and the appointed firms conduct regular surveys to provide an insight into staff views on how well they are supported to provide high-quality audit work. This information enables AQA to monitor trends over time and allows auditors to take account of the findings in developing their human resources strategies.

**43.** The results show that across all auditors, staff experience a strong culture of support to perform high-quality audits. This level has been maintained following a slight decline in 2017/18.

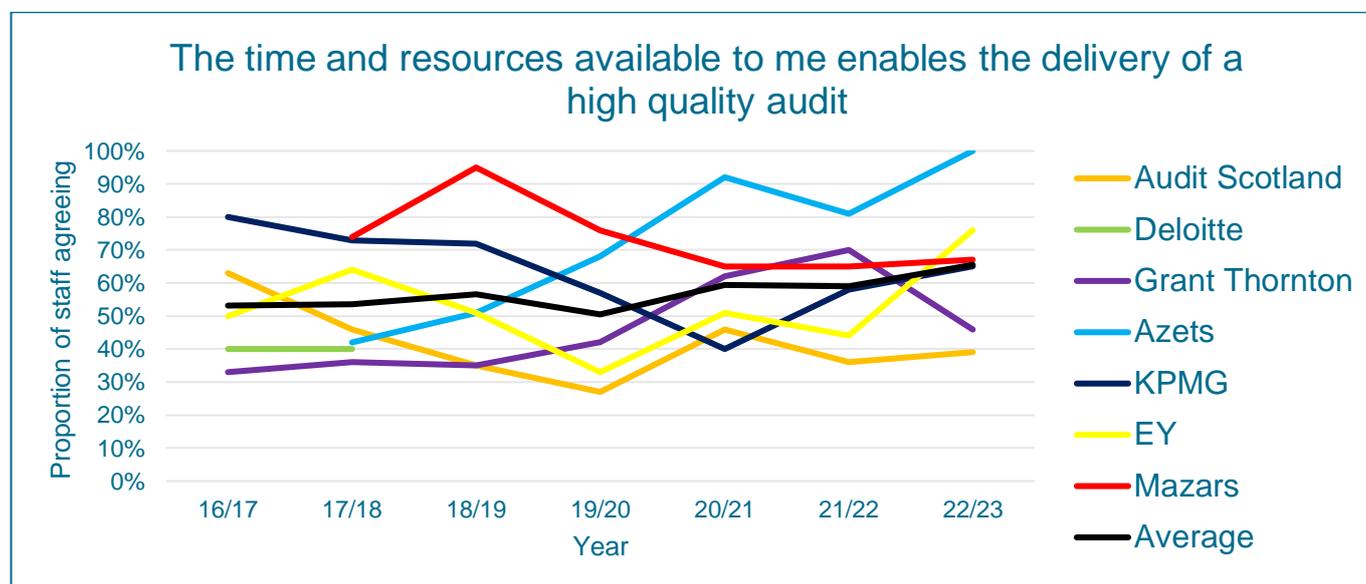


### Notes:

1. Azets and Mazars did not provide details in 2016/17. Mazars provided national data for 2017/18 and local data since.

2. Deloitte changed their method of obtaining staff views in 2017/18. A survey was undertaken in the summer 2021 which returned positive results on Deloitte supporting their staff to deliver high quality audit with some areas for improvement identified. Deloitte conducted its first global survey on the views of our people on our culture of audit quality and will develop actions based on the findings when finalised.

**44.** Most audit providers returned an improving level of staff satisfaction regarding the time and resources available to deliver a high-quality audit compared to the prior year. Azets and EY had the most noticeable improvement compared to 2021/22. Actions taken to address this perception in Grant Thornton had resulted in a consistent improvement in the last four years however their latest results have been less positive.



**45.** Staff satisfaction results at Audit Scotland have improved however this was from an already low relative position to their prior year results and other audit providers.

**46.** Evidence from the audit profession suggests that there is a shortage of skilled and qualified audit staff available. These recruitment difficulties have been confirmed by most audit providers undertaking public audit in Scotland in the last year. This capacity risk will need to be managed carefully. In the [FRC's audit inspections of 2021–22 audits](#) they highlighted audit quality issues for Mazars which were specifically linked to capacity and that Mazars has been growing too fast and continues to grow.

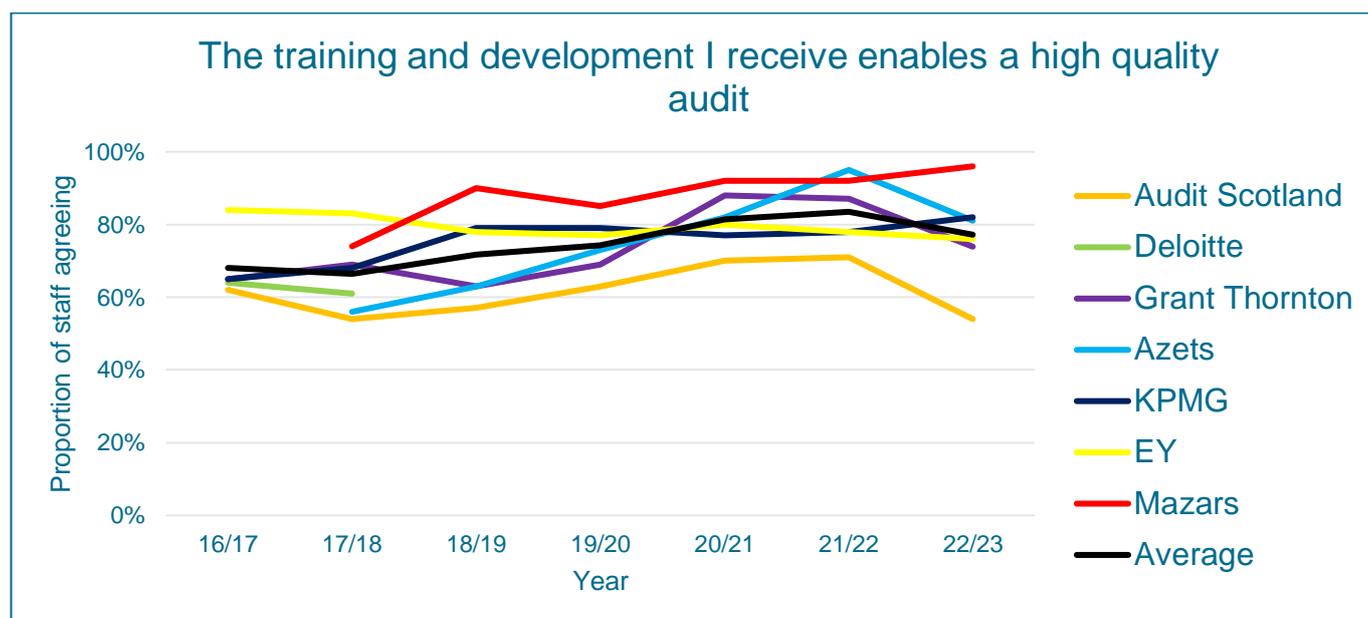
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## Recommendation

Audit providers need to align and monitor their workforce plans to ensure they have sufficient capacity to deliver their audit work to the expected quality standards.

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**47.** The survey results also show that staff continue to be supported to deliver high quality audit work through training and development provision by audit providers despite the concern of some providers over resourcing. This is less so for ASG staff who have returned to their 2017/18 levels with 54 per cent of staff returning a satisfactory response compared to 71 per cent satisfaction in 2021/22. Further investigation of the reasons for ASG survey results needs to be undertaken and remedial action put in place and the effectiveness of the remedial action monitored.



## Recommendation

Root cause analysis should be undertaken of ASG staff survey results relating to learning and development and corrective action put in place.

## Qualifications

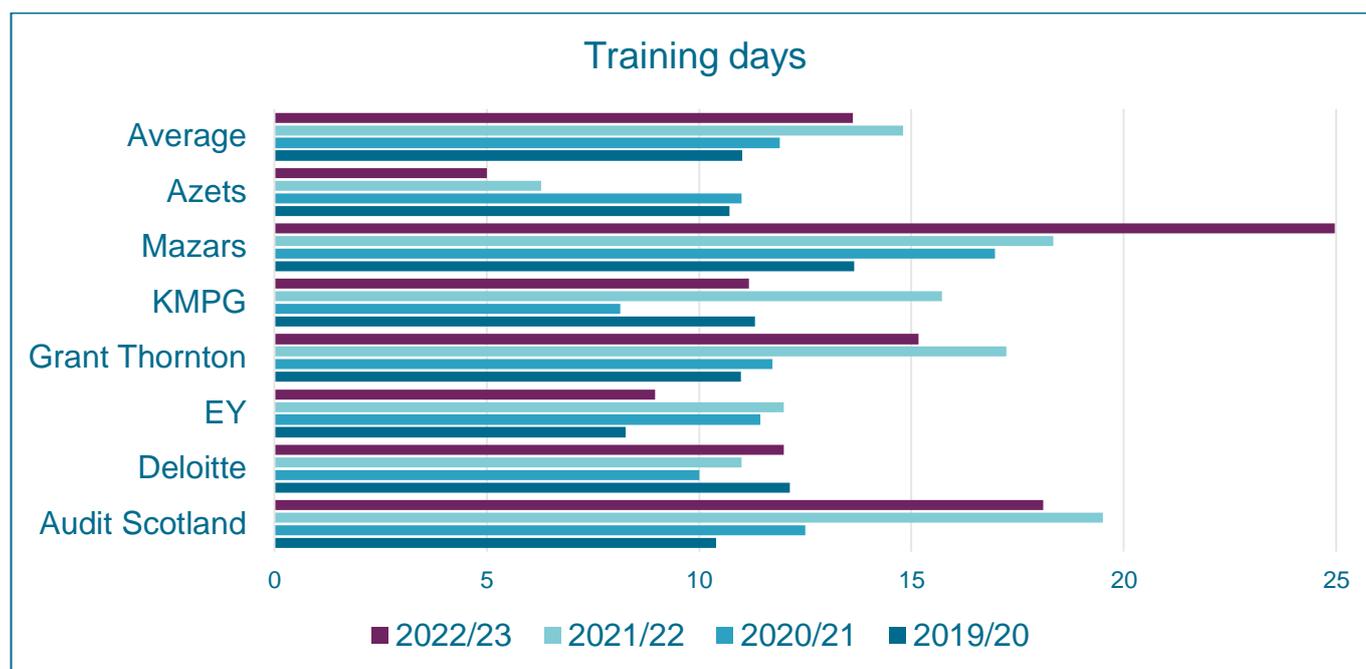
**48.** Audit work is carried out by appropriately trained and qualified individuals. The firms have 100 per cent (100 per cent in 2020/21) of their staff either qualified or in training. ASG staff were appropriately qualified, with 95 per cent of staff (97 per cent in 2020/21) either CCAB (Consultative Committee of Accountancy Bodies) or Chartered Institute of Management Accountants qualified, or in training for a CCAB qualification. Several ASG staff also hold qualifications in other areas, such as ICT.

Audit work is carried out by appropriately trained and qualified individuals.

**49.** Staff in the Performance Audit and Best Value group (PABV) have a wide range of professional and policy backgrounds. These include audit, research, and public policy-related qualifications in disciplines such as economics and social sciences. This depth and breadth of knowledge and insight across the sectors they audit supports the delivery of high-quality work. In addition, 19 per cent (21 per cent in 2020/21) of PABV staff were also either CCAB qualified or in training for a CCAB qualification during 2022, which supports flexible working across Audit Scotland.

## Training

**50.** All audit providers recognise the importance of training their staff. The average number of days that staff receive in a year are shown in the chart below. This figure excludes trainees.



**51.** The amount of time spent on training varies between auditors. 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 training with an overall average of 14 days per member of staff (compared with 15 days in 2021/22).

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

### Audit process and quality control arrangements

**53.** Audit Scotland and the appointed firms are responsible for their own organisation-wide arrangements for quality control in accordance with International Standard on Quality Control 1 (ISQC1). This sets out a firm's responsibilities for its system of quality control for audits and reviews of financial statements, and other assurance and related services engagements and professional guidance. These arrangements focus on making continuous improvements to audit work by implementing a cycle of reviews, understanding why any errors are made and by sharing good practice.

**54.** All auditors are complying with ISQC (UK) 1. The ICAS and ICAEW programme of inspections includes reviewing compliance with ISQC (UK) 1, and related operational procedures, including each firm's internal audit manual and quality control procedures. All audit providers have been reviewed in the current appointment round and no issues of note arose in this year's review.

**55.** Two new audit quality management standards, [ISQM1 and 2](#), have replaced ISQC1 for audits carried out after 15 December 2022. These standards require audit firms to develop and operate effective systems of

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Considerable investment is being made in staff training with an overall average of 14 days per member of staff.

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All auditors are complying with ISQC (UK) 1 and preparing for ISQM1.

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quality management (SoQM). Each firm's SoQM represents the mechanism that creates an environment that enables and supports audit teams to perform quality audits. How to efficiently and effectively firms use resources when planning and conducting an audit to address and improve audit quality is a key component of the SoQM. Capacity and recruitment challenges in the audit profession will make resource management even more critical going forward.

**56.** Auditors are currently transitioning between ISQC1 and ISQM1/2 quality standards and work is underway at all audit providers to meet the requirements for their 2022/23 audits.

**57.** AQA will review the new quality standards and make any necessary changes as part of the update of the AQF in Autumn 2023.

**58.** ICAEW will review compliance with these quality standards as part of their planned programme of review. This will include consideration of how effective the SoQM put in place by audit providers are at demonstrating compliance with the eight components listed in ISQM1.

**59.** 2019/20 was the first audit year that the performance audit methodology was aligned to comply with the International Organisation of Supreme Audit Institutions (INTOSAI) standards. This move to using INTOSAI standards was made in response to initial audit quality findings identified under the AQF. Compliance with INTOSAI standards for performance audits was a first among UK public audit agencies. 2021/22 was the fourth year that these audits were assessed for audit quality against compliance with INTOSAI standards.

**60.** Following the expansion of the types of performance audit products used to communicate with stakeholders, Audit Scotland are reviewing which products should comply with INTOSAI standards.

# 4. Outputs

## Reporting

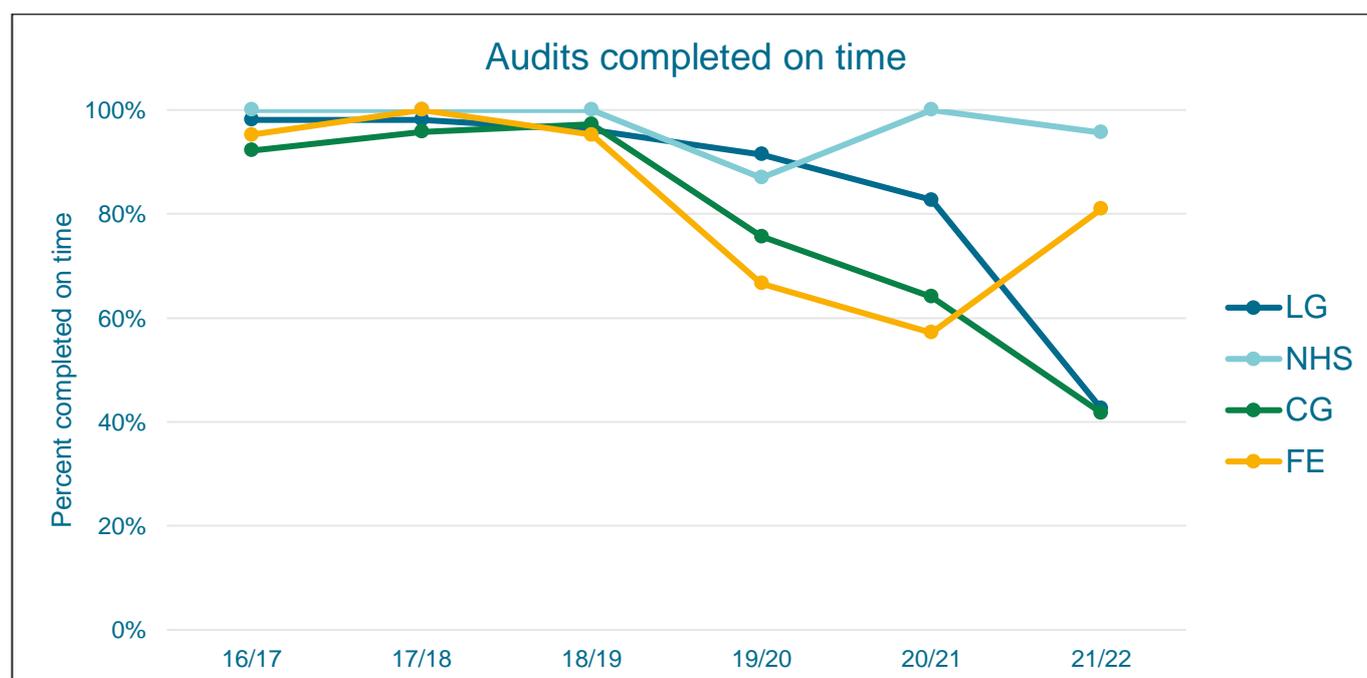
### Timeliness of financial audit work on the 2020/21 accounts

**61.** Audit Scotland sets targets for auditors to ensure that their financial audits are completed in a timely manner. Audit Scotland expects auditors to do all they can to meet the targets, but also recognises that, in some circumstances, there may be events beyond auditors' control that result in the targets being missed.

**62.** Transitional audit sign-off timetables were agreed for NHS and local government bodies in 2021/22 as sign off dates are phased back to the individual sectors pre-pandemic sign off dates. These were:

- NHS, 31 August 2022 (pre-Covid-19, this was 30 June, but was moved to 30 September for 2019/20 and 2020/21)
- Local government, 31 October 2023 (pre-Covid-19, this was 30 September, but was moved to 30 November for 2019/20 and 2020/21).

**63.** Auditors' performance in meeting the targets for 2021/22 audits and the previous five years is shown in the graph below.



**64.** Auditors completed 51 per cent of their audits on time. This was a significant decline when compared with the previous year's delivery performance of 76 per cent. When compared with the audit delivery performance prior to the pandemic, this represents an even more significant decline (in 2018/19 the 97 per cent of audits were completed on time). The decline is partly explained by the compressed 2021/22 audit year brought about by the previous year's deadline extension and the earlier deadlines for NHS and local government sectors. One 2021/22 audit opinion is still to be signed off as at 25 May 2023.

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Auditors completed 51 per cent of their audits on time.

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**65.** This widespread decline is concerning as delayed audit opinions impact on the value of external audit assurance and the ability of public bodies to make decisions based on information that has been subject to independent review.

**66.** The most common reasons for missing target dates were:

- Delays in starting 2021/22 audit work due to late sign off of previous year's audit.
- The necessary rescheduling of audited body committee timetables (resulting in sign off being delayed beyond target dates).
- Staffing pressures at audited bodies.
- Additional work required to be completed by the auditor due to emerging issues late in the audit process to ensure safeguarding of the quality of the audit process and the auditor's opinion.
- Reprioritising of audit work and resources agreed with audited bodies resulting in delays to commencement and completion of some audits.
- Resourcing issues at audit providers or within audit teams.

**67.** There is declining delivery performance across the UK public sector. AQA have reviewed progress of the 2022/23 audits. Our analysis shows that the declining performance is unlikely to improve significantly in 2022/23. As at the 31 March 2023, 73 per cent of 2022/23 audits are planned to be completed on time by audit providers. In AQA's view audit providers should formulate plans to return audit delivery performance to the pre-pandemic levels.

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## Recommendation

Auditors should prepare plans to ensure timely reporting of their work to maximise public accountability and transparency and enable prompt action to be taken by audited bodies.

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## Modification of audit opinions

**68.** Modified audit opinions are issued in circumstances where an auditor concludes that:

- the accounts contain material misstatements
- significant expenditure has been incurred in breach of rules
- a disclaimer is required as there is a pervasive uncertainty that means that the auditor cannot express an opinion or
- reporting requirements have not been met.

**69.** One auditor, Grant Thornton, modified their audit opinion by issuing a disclaimer opinion on the financial statements of Scottish Canals for the 2021/22 year-end (two modifications in 2020/21). Grant Thornton concluded:

- 'We issued a disclaimer of opinion on Scottish Canals' financial statements for the year ended 31 March 2021. The Statement of Financial Position within these financial statements recorded a property, plant, and equipment balance of £105 million, which included assets of £51 million valued on a historical cost basis.
- To comply with the 2020/21 Government Financial Reporting Manual, these assets should have been valued at current value in existing use, which represents the present value of the assets remaining potential. We were unable to obtain sufficient appropriate audit evidence to support the current value in existing use of these assets, and as a result these assets remained valued on a historical cost basis. We concluded that the possible effects on the financial statements of undetected misstatements arising from this matter could be both material and pervasive'.

**70.** Two audit opinions on the accounts were qualified by auditors. These were:

- **Scottish Environment Protection Agency** – the auditor Grant Thornton qualified their opinion due to the previous year's disclaimer opinion and the impact this had on the prior year comparative figures included within the 2021/22 financial statements. The 2020/21 disclaimer opinion was required as SEPA were unable to retrieve a significant amount of underlying financial records following a devastating cyber and ransomware attack.
- **Social Security Scotland** – the auditor ASG qualified their opinion on the regularity of expenditure and income because estimated overpayments in the benefits delivered by the DWP through agency agreements were material at £67.5 million. This expenditure was therefore not incurred in accordance with the applicable enactments.

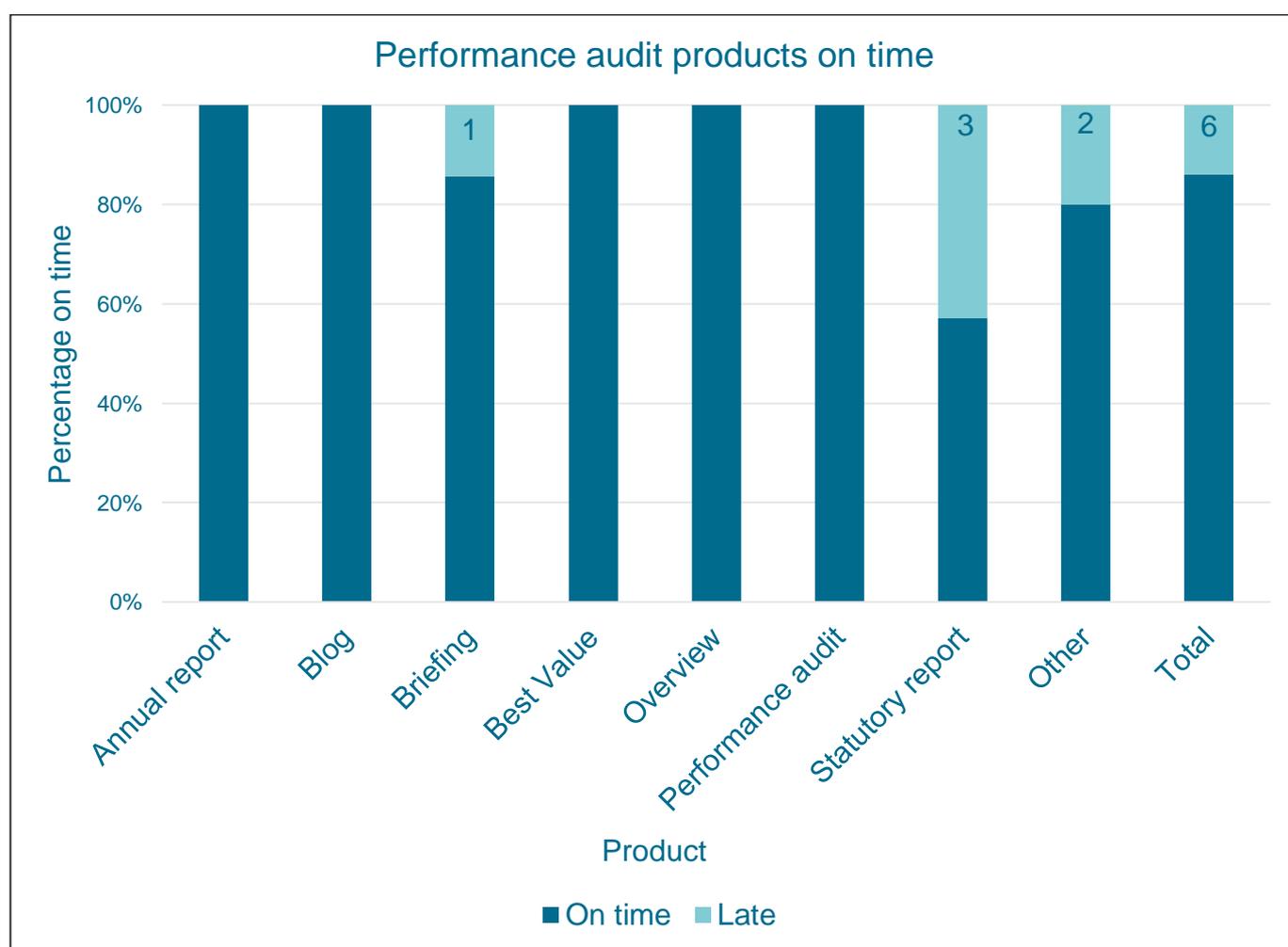
**71.** There was one instance where the auditor reported by exception (one in 2020/21) as the local government significant trading operation (STO) failed to achieve the statutory objective to break even over a three-year period.

## Publication of Performance audit and other reports

**72.** The Auditor General for Scotland and Accounts Commission each have five-year rolling work programmes that cover a range of public sector bodies and services.

**73.** A [dynamic work programme](#) was launched in 2021 to enable the publication of ongoing Covid-19 briefing papers to support public bodies and auditors during the pandemic and recovery. This programme is reviewed quarterly to ensure it remains relevant, focussed, and up-to-date and reflects the strategic priorities of the Auditor General and the Accounts Commission.

**74.** Eighty-six per cent (37 out of 43 of performance audit products were completed to planned timescales during 2022/23.



**75.** Reasons for the six late products were:

- Three of the six late products were statutory reports, and these were late due to the late sign off of the associated annual accounts of the relevant audited body.
- A joint briefing by the Auditor General and the Accounts Commission on Tackling Child Poverty was agreed to be published closer to the Public Audit Committee where it was being presented.
- The two remaining products, 'Data gaps' and 'Resourcing the benefit service', were delayed due to resource capacity and a data validation issue respectively.

**76.** During 2022/23, Audit Scotland published seven external briefing papers and nine web-based outputs, including [Tackling child poverty](#) and [Scotland's public finances: Challenges and risks](#). These products supported the Auditor General and the Accounts Commission to respond more flexibly and rapidly to emerging and dynamic matters of public interest and supported public bodies and the Parliament to understand the key messages and challenges facing public services and spending. These new outputs are based on similar arrangements to other PABV products but have not yet been subject to AQA or external evaluation.

## Quality monitoring

### Cold reviews

**77.** This section summarises the results of independent and internal cold reviews, using the Financial Reporting Council (FRC) grading system for all audit work. After a comprehensive tendering exercise, ICAEW replaced ICAS as the external reviewer for 2021/22 audits and carried out the independent cold reviews. ICAEW have extensive experience of conducting audit quality reviews for public sector audit providers including Audit Wales, Northern Ireland Audit Office, and Public Sector Audit Appointments body in England. ICAEW's wide experience should help to further increase the usefulness of the external audit quality review process and provide opportunities to create and evaluate benchmarking data.

**78.** Internal quality reviews are conducted by senior and appropriately experienced colleagues who have not been involved in the audits carried out the internal cold reviews.

## The FRC's scoring methodology applied to quality activities

Score	Standard	Description
1	 <b>Good</b>	<ul style="list-style-type: none"> <li>No concerns regarding the sufficiency and quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed.</li> <li>Only limited weaknesses in documentation of audit work, AND</li> <li>Any concerns in other areas are limited in nature (both individually and collectively).</li> </ul>
2	 <b>Generally acceptable but a small number of improvements required</b>	<ul style="list-style-type: none"> <li>Only limited concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed AND/OR</li> <li>Weaknesses in documentation of audit work are restricted to a small number of areas AND/OR</li> <li>Some concerns, assessed as less than significant (individually and collectively), in other areas.</li> </ul>
3	 <b>Some improvements required</b>	<ul style="list-style-type: none"> <li>Some concerns, assessed as less than significant, regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed AND/OR</li> <li>More widespread weaknesses in documentation of audit work AND/OR</li> <li>Significant concerns in other areas (individually or collectively).</li> </ul>
4	 <b>Significant improvements required</b>	<ul style="list-style-type: none"> <li>Significant concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed (not limited to the documentation of the underlying thought processes) AND/OR</li> <li>Very significant concerns in other areas (individually or collectively).</li> </ul>

**79.** The AQF expects audits to be assessed as 'good' (1) or 'generally acceptable, but a small number of improvements required' (2) with no concerns about the audit opinion. Auditors are expected to address any findings. Where an audit is assessed as 'some improvements required' (3) or 'significant improvements required' (4), the auditor is expected to put in place a plan to address the required improvements.

**80.** Reviewers consider whether any improvements required are specific to the audit or applicable to the firm's procedures. Findings that relate to a firm's procedures apply equally to all sectors.

**81.** The cumulative reporting is important as it increases the sample size over the timeframe of the AQF and provides a better evidence base for conclusions to be made on the overall quality of auditors' work.

**82.** The AQF established targets in 2019. The target for the percentage of cold reviews showing good compliance with auditing standards (1 and 2) was set at 80 per cent cumulative over three years.

Type of review	Aggregate 3-year cumulative at target			Previous year's 3-year cumulative at target <sup>1</sup>
	Auditor General	Accounts Commission	Aggregate	Aggregate
Independent financial audit	63%	86%	<b>70%</b>	65%
Independent performance and Best Value audits	100%	100%	<b>100%</b>	100%
Internal financial audits	72%	94%	<b>80%</b>	79%
Internal performance and Best Value audits	75% <sup>2</sup>	100% <sup>2</sup>	<b>75%<sup>2</sup></b>	100%

Notes:

- The changes to the numbers of audits falling within each grading from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For these reasons changes in the cold review results from one year to the next are not necessarily indicative of any overall change in audit quality and need to be considered in the context of other information available.
- Where joint performance audits have been carried out by the Auditor General and the Accounts Commission these have been counted in both their separate results but only once in the aggregate result for internal performance audit and Best Value reviews.

### Independent external reviews

**83.** Independent external assurance offers the highest level of assurance to stakeholders. ICAEW replaced ICAS for 2021/22 independent reviews following a successful tendering exercise in 2022.

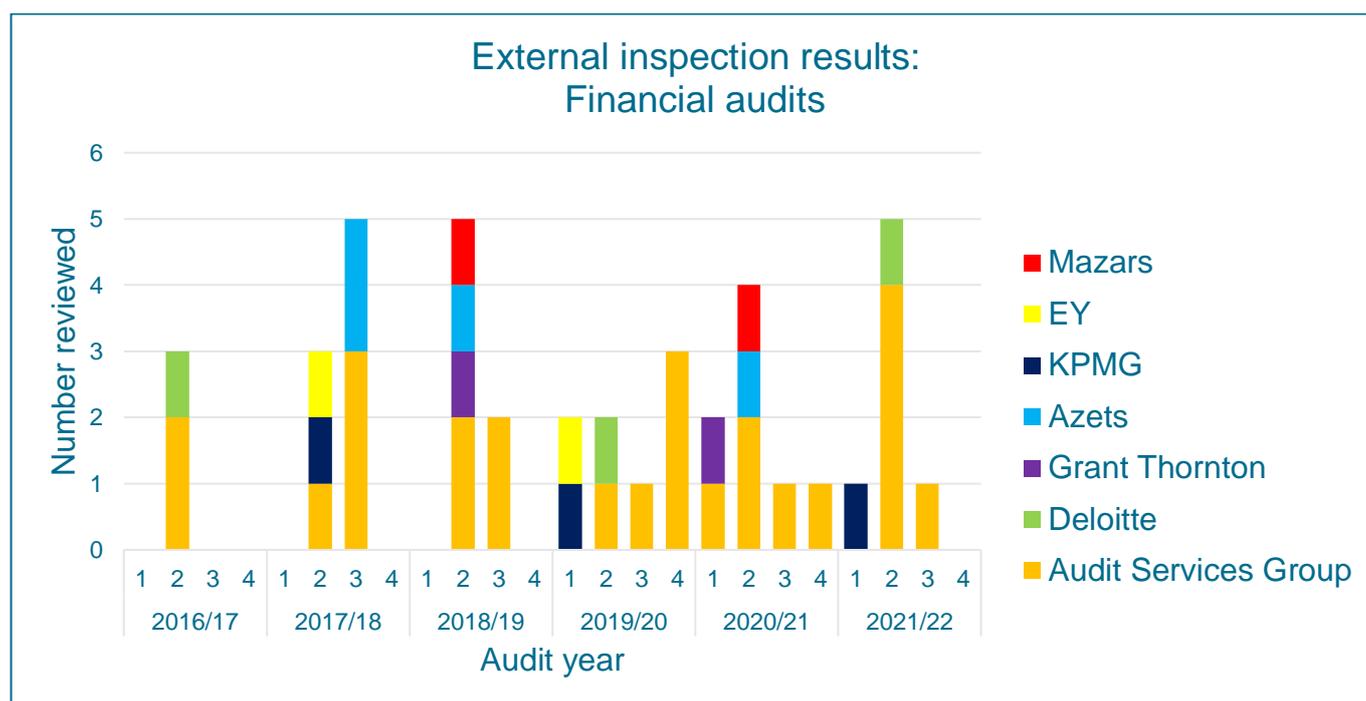
**84.** Over the last six years ICAS and ICAEW have reviewed all six appointed firms, all Audit Directors in Audit Scotland responsible for financial audits, and all Audit Directors leading on performance audit and Best Value assurance reports over the course of the last five years.

**85.** ICAEW assessed 86 per cent of 2021/22 financial audits reviews as good or generally acceptable but a small number of improvements required (1 or 2) compared to 75 per cent of 2020/21 financial audits.

Independent external assurance offers the highest level of assurance to stakeholders.

**86.** Over the last three years ICAS and ICAEW have assessed 70 per cent (65 per cent previous year) of financial audits as good or generally acceptable but a small number of improvements required. The ICAEW and ICAS reviews of financial audits over this three-year period show the external auditors did not meet the aggregate three-year target of 80 per cent, but that audit quality is steadily improving.

**87.** ICAEW assessed that 100 per cent of performance and Best Value audits reviewed met the expected quality standard. The ICAEW reviews show that performance audit target did meet the aggregate three-year target of 80 per cent.



### Audit Services Group

**88.** ICAEW reviewed five ASG audits and graded four financial audits as grade 2 meeting the expected quality standards set. One audit failed to meet the expected standard (graded as 3). ICAEW did not find any issues which impacted directly upon the auditors' opinion in the independent auditors' report. ICAEW also did not find any ASG audits where significant improvements were required (grade 4). This is an improvement upon 2020/21 (one audit graded as 4) and 2019/20 (two audits graded as 4).

**89.** ICAEW reviewers identified several areas of good practice in the individual audit files, which included:

- Clear and comprehensive documentation on the audit file which demonstrated a good understanding of the client and relevant audit risks.
- The sample size justification for non-pay expenditure was clearly documented.

- The service organisation controls over expenditure were comprehensively reviewed.
- An error identified in the testing of assets was clearly justified as being an isolated occurrence.

**90.** Areas of good practice should be shared and adopted by auditors to enhance compliance with professional standards.

**91.** ICAEW reviewers also found several areas for further improvement which included:

- The audit team correctly identified a component entity as being significant. However, their review of the component auditor's work was limited to reviewing a completed questionnaire. For a significant component, this is insufficient to provide the audit team with assurance over that work and they should instead request that the component auditors provide their detailed working papers for the audit team to review, to enable the audit team to reach their conclusion as group auditors.
- The auditors' working papers did not adequately explain the rationale on how they had calculated the sample sizes for substantive testing. They did not consider the link between sample sizes and audit risks.
- The audit team's approach to the substantive testing did not ensure that they identified and tested all material items.
- The audit team did not carry out sufficient work to confirm the accuracy of the information provided to the actuary for calculating the pension fund liability. Though reliance was placed on the work of the pension fund auditor, this was limited to the work of the actuary and did not cover information supplied by the administering body or the audited entity.
- ICAEW identified several improvements required to the audit approach on asset valuations, particularly around demonstrating more challenge around the underlying assumptions.
- For journals testing, it was unclear how the sample size selected by the audit team was sufficient to address the significant risk due to management override.
- The audit team chose their sample for journals testing without carrying out any procedures over the population to ensure that it was complete.
- The method used by the audit team to conduct their testing of income and creditors meant that they had insufficient evidence over the completeness of these areas.

**92.** ICAEW reviews strongly indicate that if these specific areas could be addressed by ASG, then all audits would meet the expected quality standard.

AQA would encourage ASG to prioritise these areas as part of their overall efforts to improve compliance with professional standards.

**93.** In last year's quality of public audit in Scotland annual report we highlighted the need for ASG to learn from and respond to all of the cold review findings and agreed actions. We recommended that root cause analysis is adopted to group common findings and identify any factors that have impacted on the number and nature of findings noted.

**94.** Audit Scotland have responded by forming a new business group (Innovation and Quality) which is focused on improving the quality of the audit work. ASG have also formulated an improvement plan to address previous action points. However, in AQA's view there is an urgent need to prioritise the plan to ensure that there is a focus on the areas that will provide greatest impact.

**95.** ICAEW have produced a document ('Root Cause analysis: action planning and continuous quality management'). AQA recommend that Audit Scotland consider adopting the best practice identified by ICAEW to strengthen the effectiveness of action plans.

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## Recommendation

There is now an urgent need to prioritise the action plan that has been prepared by Audit Scotland in response to the 2022 QPAS report findings and other improvement plans plan to ensure that work is focussed on the areas that will have a positive impact in continuing to improve audit quality.

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### Private firms

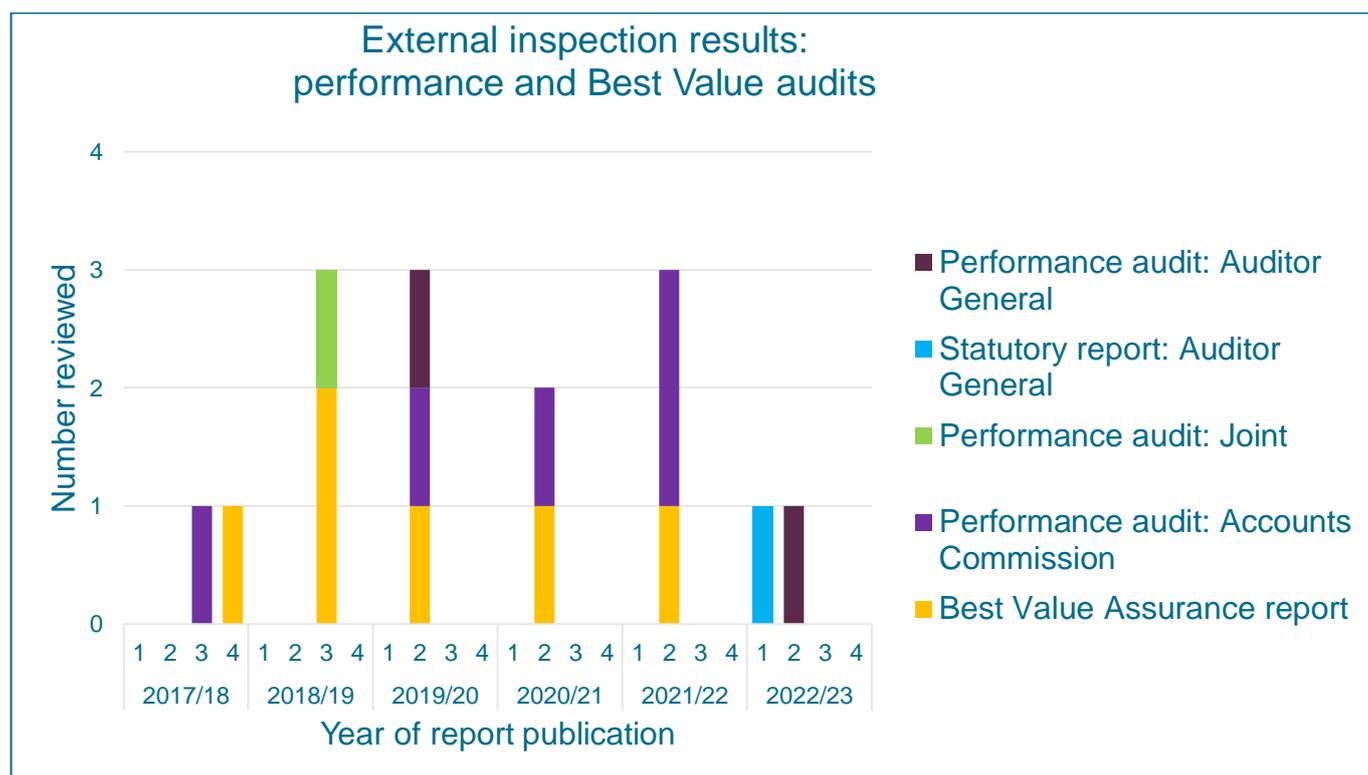
**96.** ICAEW and ICAS found that all of the accountancy firm audits met the expected quality standard of audits being graded as 'good' or 'generally acceptable, but a small number of improvements required' for the last four years.

**97.** ICAEW reviewed the 2021/22 audit work of two of the six audit firms (KPMG and Deloitte). ICAEW scored KPMG as '1' and Deloitte as '2'. This means that that the 2021/22 audit work of both audit firms reviewed by ICAEW has met the expected audit quality standard.

**98.** KPMG has consistently scored highly in all independent previous external quality reviews. Deloitte has also consistently met the expected quality standard in all previous independent external quality reviews.

### Performance audit and Best Value audits

**99.** ICAEW reviewed two performance reports. For the first time a Performance audit was awarded the highest score available by independent reviewer. The other review also met the expected standard.



**100.** These results mean that this is the fourth year that PABV reports have met the expected standard for the quality of their audit work, being graded as ‘good’ or ‘generally acceptable, but a small number of improvements required’.

**101.** ICAEW reviewers did find several areas where further improvements could be made, which included:

- Clarification of the audience for some statutory reports.
- Clarification on whether all performance audit products are expected to comply with the INTOSAI standards.
- Opportunities to simplify the language used in the reports to increase the clarity of the reports.
- Instances where ICAEW reviewers asked for further explanation and presentation of supporting evidence to aid their understanding of the report.
- Consideration needs to be given to following up and commenting on progress made against the recommendations made in previous reports.

## ICAEW Audit Scotland summary

**102.** ICAEW provided the following comments on the audits that they reviewed:



ICAEW undertook seven cold file reviews of financial audits, five covering Audit Scotland and two covering a sample of appointed firms. In addition, two performance audits, both conducted by Audit Scotland were also inspected.

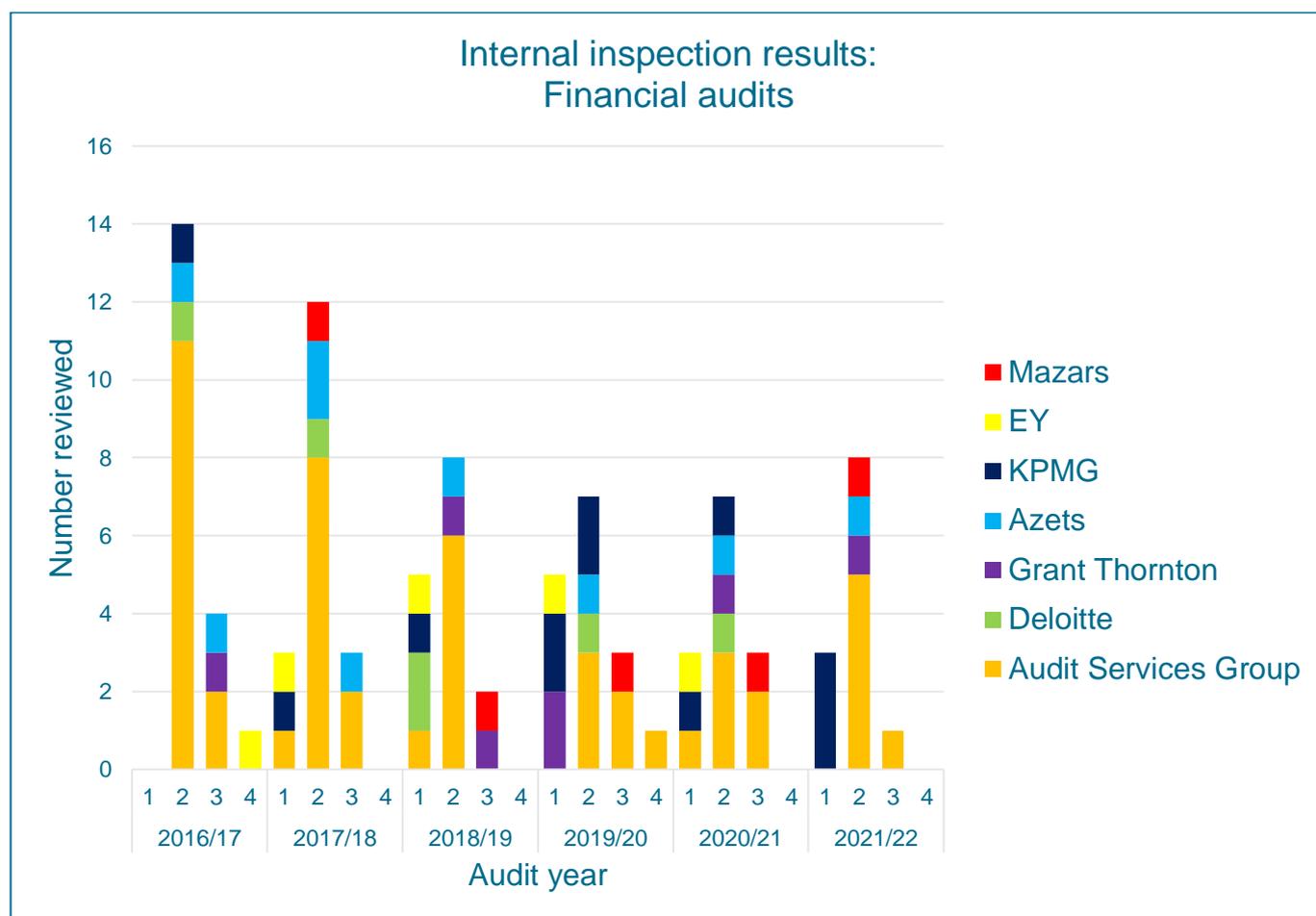
The quality of audit work, across financial and performance audits, was of a generally good standard. On the financial audits covering Audit Scotland, four of the five engagements reviewed were generally acceptable. On the remaining engagement which required improvement, the key issue related to insufficient review of a component auditors working papers for a subsidiary which is very significant in the context of the group audit opinion. The performance audits conducted by Audit Scotland and the two financial audits covering the appointed firms were either good or generally acceptable.

Good practice was identified across all files reviewed and mainly related to aspects of comprehensive and clearly documented audit work.

Audit Scotland's whole-firm procedures are generally appropriate for the size and nature of the organisation and is making appropriate progress in implementing International Standard on Quality Management (ISQM)<sup>1</sup>. The key aspects of whole-firm procedures, relevant to auditing public bodies, for the two appointed firms covered in this limited review are also generally appropriate.

### Internal cold reviews carried out by appointed auditors

**103.** Internal audit quality reviewers assessed 92 per cent of 2021/22 financial audits as 'good' or 'generally acceptable but a small number of improvements required' (1 or 2, 75 per cent of 2020/21 financial audits).



**104.** The overall aggregate three-year score for internal quality reviews of financial audits was 80 per cent (79 per cent in 2020/21). Internal reviewers did not identify any concerns with audit opinions for 2021/22 or find any audit required significant improvements (grade 4).

**105.** In 2021/22, Deloitte's internal quality control team did not select financial statements audit for review but selected a grant claim which is an area that forms part of the appointed auditors' responsibilities under the Code. The File was scored as '1' (good). The engagement lead at Deloitte has had 10 cold reviews during this appointment round including this year by ICAEW. All reviews met the expected standard.

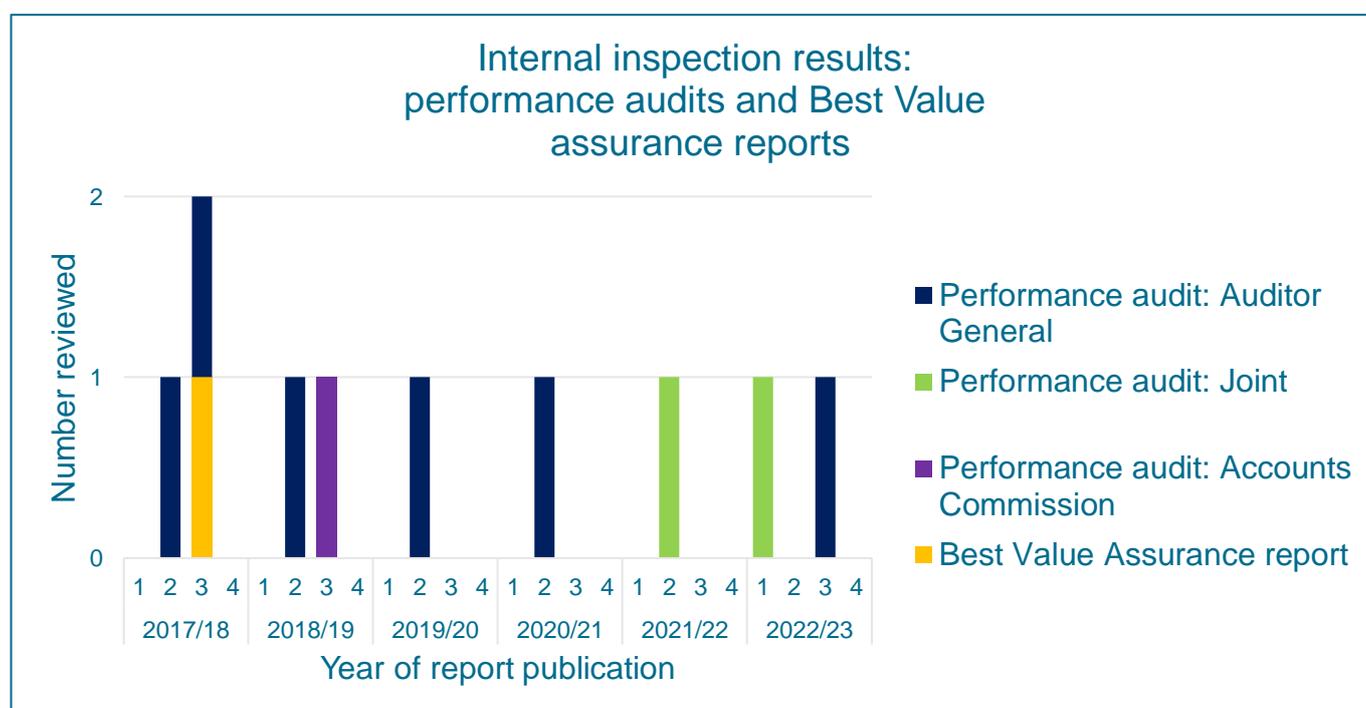
**106.** Audit Scotland conducted six internal quality reviews of 2021/22 financial audit work. Five of these six reviews scored '2' and met the expected quality standard. The sixth internal review was graded as '3' and did not meet the expected standard. The review found several areas where the audit approach adopted by the audit team did not comply with the international auditing standards.

### Internal reviews carried out by PABV

**107.** Audit Scotland's internal quality review team carried out two internal cold reviews of performance audit reports published in 2021/21 (one in 2020/21). One of the reviews scored was scored as '1' (good). The other one was scored as '3' (some improvements required) due to some areas where the audit approach adopted by the audit team did not comply with the INOTOSAI standards.

### Recommendation

AQA recommends that Audit Scotland conducts root cause analysis on the financial and performance audits that were scored '3' (some improvements required) to determine the reasons for non-compliance with international auditing standards and the corrective action required to bring this audit to the expected standard.



### Improvement feedback for auditors

**108.** Auditors received detailed reports on each audit reviewed. Root cause analysis and action plans should be developed by auditors to include improvement areas identified. Good practice areas should be shared to ensure auditors are aware of and adopt practice that meets professional standards. AQA will monitor how well the action plans are delivered and as part of their regular meetings with auditors. Audit Scotland, working together with all auditors through sector meetings, will continue to share best practice to support improvements in the quality of public audit in Scotland.

## Annual audit reports

**109.** AQA reviewed 25 2021/22 annual audit reports (AARs) for compliance with the requirements of the [2016 Code of Audit Practice](#), [Guidance on planning the audit 2021/22](#) and International Standards on Auditing (UK) (ISAs (UK)).

**110.** The sample was selected to give a good representation of all sectors. The reviews covered four areas:

- financial audit work
- wider scope audit and best value work
- how the audit team adds value to the audit process
- an overall assessment of the readability and understandability of the AARs.

AQA also followed up the recommendations for improvement made in 2022 QPAS report.

**111.** Our review found that the majority of the AARs (22 out of 25 AARs) demonstrated a high level of compliance with the guidance. Our review also found several areas of good practice as well as four areas where AARs could be improved. We have shared the good practice with all auditors. We have also discussed the areas where the AARs could be improved with relevant auditors. The recommended improvements are:

- ASG should ensure that all its non-council local government AARs fully comply with the requirements of the Code by containing an explicit conclusion for each of the wider scope audit areas.
- ASG and KPMG should comply with the Guidance on planning the audit by ensuring that AARs are correctly addressed.
- KPMG should ensure that all their AARs contain a reference to the level of performance materiality that has been set and how this applied by the auditor in their audit of the accounts.

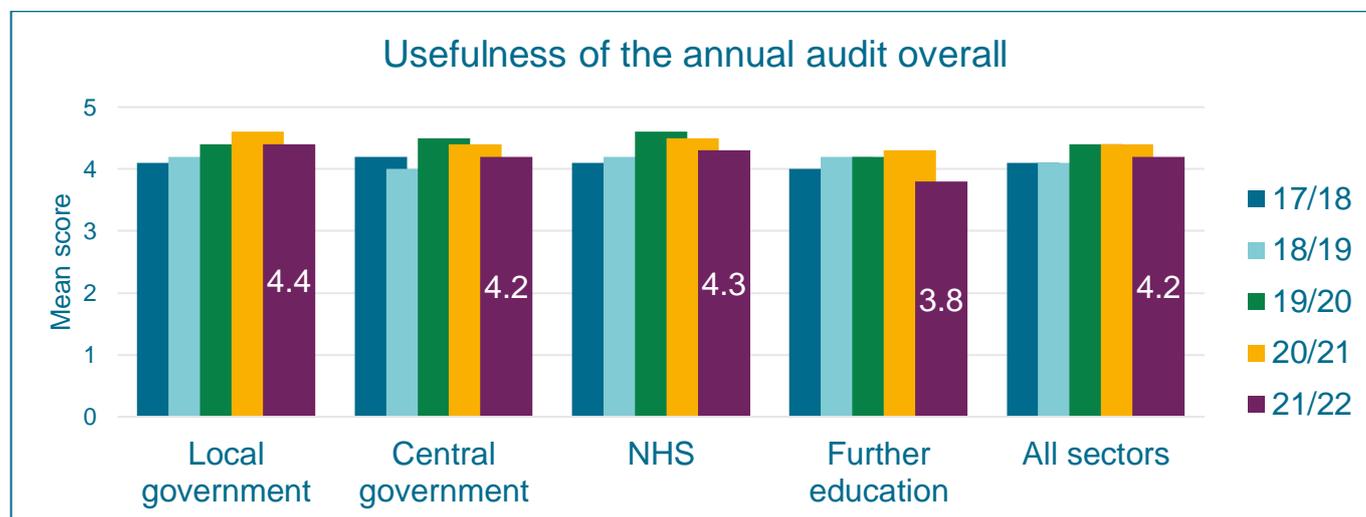
## Impact

### Audited bodies' views on audit work

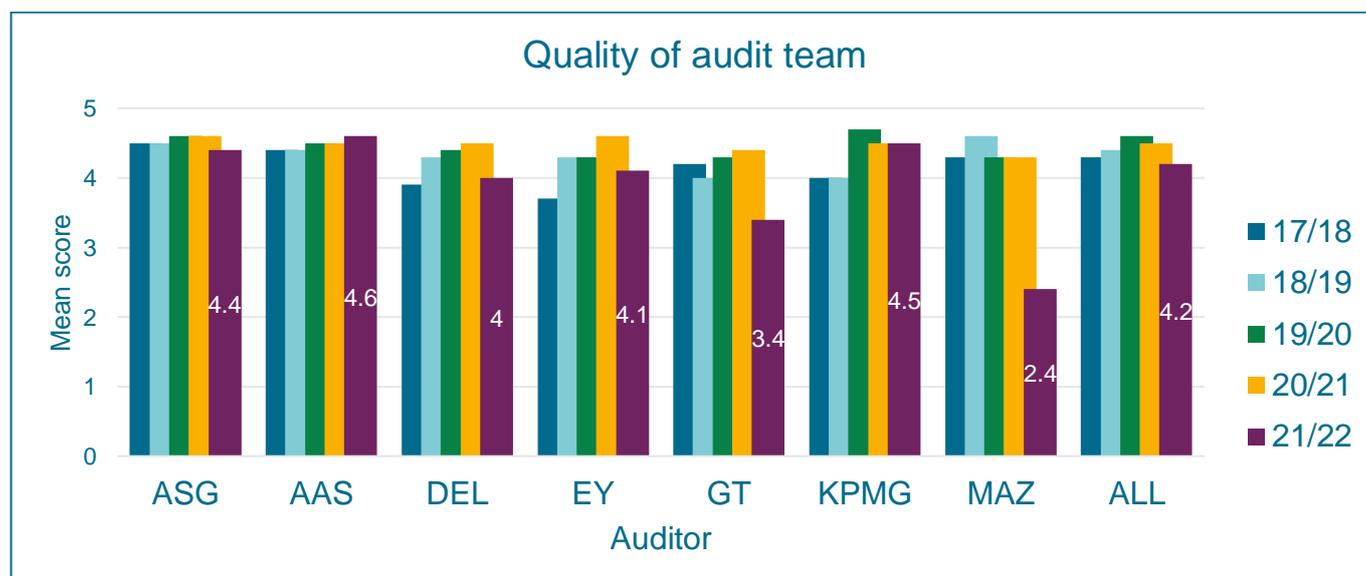
**112.** The Diffley Partnership was commissioned in 2021 to undertake the annual independent stakeholder feedback survey. It surveyed 472 individuals (568 in 2021/22) in audited bodies to gather feedback on the 2021/22 financial audits, Performance audits, overview reports and Best Value assurance reports published in the past year. There were 197 respondents (42 per cent, 36 per cent 2020/21). Audited bodies were asked to respond to questions using a scale of 1 to 5 where 1 is 'very poor' and 5 is 'very good'.

## Financial audit

**113.** The conclusions on the usefulness of the annual audit have declined marginally this year. Stakeholders' perception of the usefulness of the audit remains high with 81 per cent considering the annual audit to be fairly or very useful, which has been consistent since 2017/18. However the proportion considering the audit very useful has declined from 59 per cent to 46 per cent.



**114.** The delays in completing previous years' audits affected by the coronavirus pandemic continued to impact on how auditors conducted their audits in 2021/22. Audits continued to be completed mostly remotely. Despite these challenges, the performance of the annual audit teams continued to score highly. The majority, 81 per cent (91 per cent in 2020/21) thought that the annual audit team performed fairly or very well.



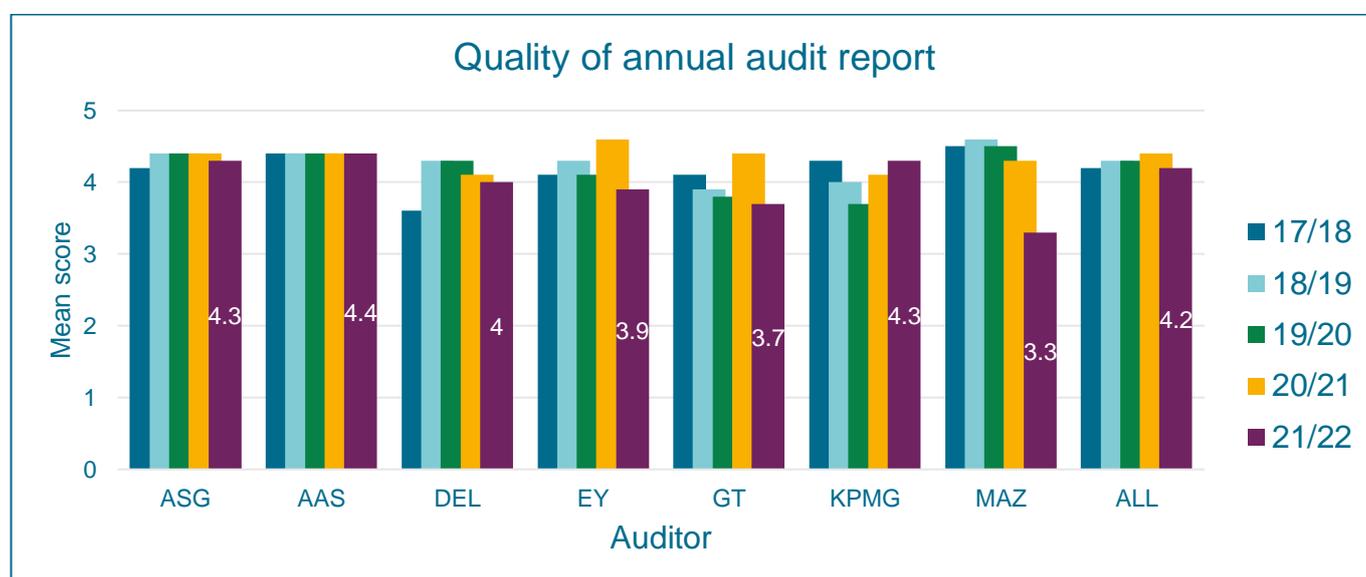
**115.** This year, three in four (77 per cent) of respondents thought their auditor managed remote auditing well, with half (53 per cent) saying they managed very well. While positive overall, these rates are down from 2021, signalling new issues for auditors to manage as we emerge from the pandemic and enter a more hybrid model.

“This was the final year in our auditors appointment. I feel the relationship built with the auditor has been a positive in our audits. Our Auditor has been helpful in their advisory capacity, willing to engage and discuss issues and overall we feel this appointment has been a positive and successful period.”

“The main issue for us has been the delay to audits concluding – a knock on effect from the pandemic – which has impacted other work.”

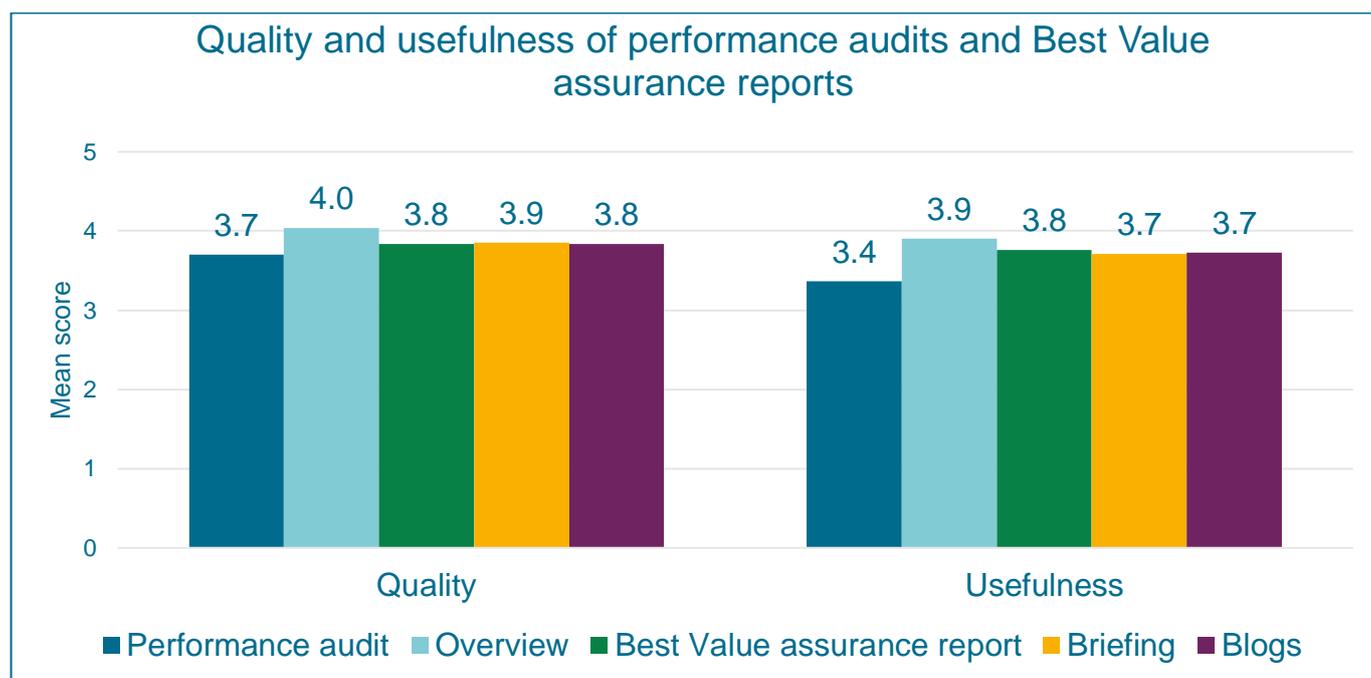
“Disjointed working from auditors, different auditors asking for the same information. Requests and queries via email were not clear of actual requirements, causing more time and work.”

**116.** Perceptions of the annual audit report remain positive, with almost all (80 per cent (2021 87 per cent)) of stakeholders finding the annual audit report very or fairly useful. This is a reversal of the last four years of increases, with levels back to the level seen for 2017/18 audits.



### Performance audit and Best Value assurance reports

**117.** Audited bodies expressed positive views on the quality and usefulness of Performance audits, overview reports, Best Value assurance reports, briefings and blogs. Perceptions of all reports decreased compared to the previous year in both quality (4.3 to 3.9) and usefulness (4.2 to 3.7).



## Adding value

**118.** The Code requires auditors to recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do.

**119.** Some summarised examples provided by auditors over the last year where they have added value at audited bodies are:

- using experts on valuations to increase professional scepticism and challenge
- supporting the reporting of the impact of climate change
- relaunching a forum for non-executive directors to aid improvements in governance
- making useful recommendations for improvement
- avoiding material misstatements in published financial statements
- promoting effective governance and performance including member training
- supporting bodies with issues and implications arising from statutory reports.

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# 5. Areas for improvement and future focus

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## Areas for improvement

**120.** The evidence base under the AQF continues to grow and comprises an assessment of compliance with the highest professional standards and the achievement of impact and other qualitative measures.

**121.** Work carried out under the AQF has highlighted areas where further improvements are needed to support the Auditor General for Scotland and Accounts Commission's drive towards high quality public audit. AQA will monitor improvement areas identified this year.

**122.** The evidence will be used in discussion with relevant audit providers to focus on areas for improvement including:

- **More rigorous review of component auditor's work by group auditors.** ICAEW identified several areas where ASG's audit work to group accounts did not fully comply with the requirements of ISA (UK) 600. Where a component entity is significant the auditor should not limit their work to reviewing a completed questionnaire and they should instead review the detailed working papers for the audit team to review, to enable the audit team to reach their conclusion as group auditors.
- **Improving ASG's approach to substantive sample testing.** ICAEW identified several areas where ASG's approach to sample testing could be improved. These included: ensuring that the auditors' working papers adequately explain the rationale on how the auditor had calculated the sample sizes, consider the link between sample sizes and audit risks, and ensuring that the audit team identified and tested all material items.
- **Increasing the challenge around pension information.** ASG should conduct sufficient work to confirm the accuracy of the information provided to the actuary by the administering body or the audited entity.
- **Greater professional scepticism in the audit approach to asset valuations.** ASG should demonstrate more challenge around the underlying assumptions when auditing assets.
- **Conducting sufficient journals testing.** ICAEW found two significant issues on ASG's approach to journals testing. Firstly, it was unclear how the sample size selected by the audit team was sufficient to address the significant risk due to management override. Secondly, the audit team

chose their sample for journals testing without conducting any procedures over the population to ensure that it was complete.

- **Sufficient appropriate audit evidence over the completeness of income and creditors.** ICAEW found that the method used by ASG to conduct their testing of income and creditors meant that they had insufficient evidence over the completeness of these areas.
- **Appropriate use of substantive analytical procedures.** ICAEW found that Deloitte used substantive analytical procedures for assurance over non-pay expenditure and associated trade and other payable balances. The file did not sufficiently demonstrate that it was appropriate to apply certain assumptions used in these analytical procedures. In ICAEW's view these procedures were therefore insufficiently precise to detect material misstatement.
- **Ensuring audit documentation is complete.** ICAEW recommended that Deloitte's audit documentation could be improved by recording the audit work done on an associate entity's net assets.
- **Improvements to performance reports.** ICAEW recommended several improvements to performance audits including clarification of the audience for some statutory reports; clarification on whether all performance audit products are expected to comply with the INTOSAI standards; and opportunities to simplify the language used in the reports to increase the clarity of the reports.

## Financial Reporting Council (FRC) audit inspections 2021–22

**123.** In July 2022, the FRC released its latest audit quality inspection reports, covering seven Tier 1<sup>1</sup> firm's audit work in the private sector, for their 2021/22 inspection cycle. All seven audit firm reports can be found on the [FRC's website](#) (five of these firms are appointed to conduct public audit in Scotland). The FRC's 2021/22 results show that audit quality continues to improve at the largest audit firms and on the largest audits. Of the audits inspected, 75 per cent were categorised as good or limited improvements required (audit quality scores of 1 or 2). This is an improvement on the last two years (up from 71 per cent and prior to that 67 per cent).

<sup>1</sup> The Tier 1 audit firms comprise the largest audit firms: BDO LLP, Deloitte LLP, Ernst & Young LLP (EY), Grant Thornton UK LLP (GT), KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP (PwC). Out of these audit firms, BDO LLP and PwC LLP are not appointed to carry out public audit in Scotland.

**124.** In October 2022, the FRC also published its report on the audit quality inspection of [Major Local Audits](#), which covers the audit of local government and NHS bodies in England. This audit work was conducted by six large audit firms,<sup>2</sup> five of whom are appointed to conduct audits of Scottish public sector bodies. This found that 70 per cent of financial statements audits as requiring no more than limited improvements, the same as in the previous year. This is an improvement on the 46% average over the preceding three years.

**125.** The FRC's inspection results are broadly consistent with the results of the independent and internal cold reviews of 2021/22 Scottish public body financial audits.

### **Wider issues that impact upon audit quality and the audit profession**

**126.** After several high-profile cases in the corporate sector, where the financial audit process failed to detect and prevent company failures, the auditing profession is trying to regain the trust and confidence of the public.

**127.** In May 2022, the UK Government published their response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems white paper [Restoring trust in audit and corporate governance](#). In their response the UK Government confirmed a range of measures to improve governance and auditing arrangements. The main measures which directly impact upon the auditing profession are:

- the creation of a new audit regulatory body, which will take over from the Financial Report Council (FRC), the Audit, Reporting and Governance Authority (ARGA). ARGA will have the overarching objective to protect and promote the interests of investors, other users of corporate reporting and the wider public interest. ARGA's operational objectives will focus on quality, competition and acting as an effective 'system leader' for local public audit (audit of English local government bodies)
- improving the informativeness and quality of audit. The UK Government is looking to ARGA to drive improvements in audit quality by steadily improving audit standards and practice
- the UK Government will ask professional accountancy bodies to improve auditor qualifications, skills, and training to create a more effective and distinctive audit profession.

**128.** The legislation to create ARGA has been delayed (the UK Government originally planned to pass the legislation in 2023). In the meantime, the FRC has published its [draft three-year plan](#) for 2023–26 which sets out the FRC's

<sup>2</sup> The six firms that conduct Major Local Audits are: BDO LLP, Deloitte LLP, Ernst & Young LLP (EY), Grant Thornton UK LLP (GT), KPMG LLP, Mazars LLP. Out of these audit firms, only BDO LLP is not appointed to carry out public audit in Scotland.

plan to transition to ARGA. The main messages that are coming from the FRC's plan are:

- audit should always act in the public's best interests
- a strong independent regulator underpins the UK's entire audit ecosystem by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them
- winning back the public's trust will bring better outcomes for all interested stakeholders.

**129.** To achieve its priorities, the FRC has devised the Four Faces approach:



**130.** The System partner and Facilitator faces are linked to improvement priorities at the audit firms. The Supervisor and Enforcer faces are focussed on assessing the effectiveness of the application of standards and holding to account audit firms when they fail to meet the expected standards. We note that the FRC's four faces model has many similarities to the Audit Quality Framework used to monitor the quality of the audit work of public bodies in Scotland.

**131.** We believe that the auditing of public bodies in Scotland is in a strong position, where our public audit model contains safeguards that ensure the independence and robustness of our audit work. In particular, the independence process of appointing the external auditors for almost all Scottish public bodies is a particular strength of the Scottish public audit model (the Auditor General selects the auditors for central government bodies, including the Scottish Government, NHS boards and colleges and the Accounts Commission for local government bodies). Nevertheless, there are lessons to learn from the changes that are occurring in the corporate auditing profession that apply to public sector auditors, such as, for all auditors to continue to undertake specialised training in auditing. We will continue to monitor these important developments. The Auditor General for Scotland reflected upon these issues in the publication: [no room for complacency](#).

**132.** In November 2022 the FRC published the report: [what makes a good environment for auditor scepticism and challenge](#). The FRC's report states: "It is vital that a good audit recognises the need for an audit team to not only have the necessary skills and experience but that it also approaches the engagement with the right behaviours and mindset." This publication encourages auditors to have the right mindset when conducting their work and how audit firms can help instil a culture of professional scepticism and challenge when performing audits.

**133.** As well as improving the quality of the audit work, the FRC is encouraging companies and other organisations to improve the quality of their annual reporting. In December 2022, the FRC published the report: [what makes a good annual report and accounts](#). The report states the attributes of a high-quality annual account and report as being:

- compliant with relevant accounting standards
- responsive to the needs of stakeholders in an accessible way
- demonstrative of the corporate reporting principles and effective communication characteristics outlined in the FRC's publication.

**134.** AQA is actively encouraging all auditors to read these important research documents to help to further improve both the quality of their audit work and governance arrangements in the organisations they audit.

# Appendix

KPI	Target	Actual	Conclusion
Value of non-audit services carried out during the audit year. (Paragraphs 38 to 40)	Steady or declining value	£55k representing 0.25% of total fees during the 2021/22 audits (£44k representing 0.2% of total fees during 2020/21 audits)	 Target met
Percentage of audit providers confirming compliance with ethical guidance. (Paragraph 37)	100%	100%	 Target met
Percentage of audit staff with appropriate qualifications and in training. (Paragraphs 48 to 49)	100%	100% for private firms	 Target met
		95% for Audit Scotland	 Target not met
Number of training and development days delivered per member of staff. (Paragraphs 50 to 52)	Steady or increasing	14 days (15 days 2020/21)	 Target met
Percentage of cold reviews showing good compliance with auditing standards. (Paragraphs 77 to 108)	80% Cumulative over three years	ICAEW/ICAS financial audits: 70%	 Target not met
		Internal financial audits: 80%	 Target met
		ICAEW/ICAS PABV audits: 100%	 Target met
		Internal PABV audits: 75%	 Target not met

KPI	Target	Actual	Conclusion
Percentage of audits completed on time. (Paragraphs 61 to 71)	95%	51% (76% for 2020/21 audits)	 Target not met
Percentage of audits with material prior period adjustments due to error.	Less than 10%	6.9% (7.1% for 2020/21 audits)	 Target met
Percentage of Performance Audit and Best Value assurance reports published as planned. (Paragraphs 72 to 76)	90%	86% (100% for 2022)	 Target not met
Perception of the usefulness of the audit overall (Paragraphs 113 to 116)	4/5	4.2 (4.5/5 for 2020/21 audits)	 Target met
Perception of the appropriateness of coverage of Best Value (LG only).	4.0	4.1	 Target met
Perception of the quality of:			
1. Overview reports	4.0	4.0	 Target met
2. Performance audits	4.0	3.7	 Target not met
3. BVARs  (Paragraph 117)	4.0	3.8	 Target not met
Perception of the usefulness of:			
1. Overview reports	4.0	3.9	 Target not met
2. Performance audits	4.0	3.4	 Target not met

KPI	Target	Actual	Conclusion
3. BVARs	4.0	3.8	 Target not met
<a href="#">(Paragraph 117)</a>			
Staff survey results on:	Steady or increasing		
1. I am encouraged to carry out a high-quality audit		95% (97% 2021/22)	 Target met
2. The time and resources available to me enables the delivery of a high-quality audit		66% (59% 2021/22)	 Target met
3. The training and development I receive enables a high-quality audit.		77% (84% 2021/22)	 Target not met
<a href="#">(Paragraphs 41 to 47)</a>			

# Quality of public audit in Scotland

Annual report 2022/23

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