

# Quality of public audit in Scotland

Annual report 2021/22



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## **Audit Quality and Appointments**

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

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# Key messages

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## Operating environment

1. During 2021/22, the Scottish Government delayed the accounting and auditing deadlines for a second year, for NHS and local government bodies, to support the recovery from the pandemic. The Auditor General for Scotland and Accounts Commission revised their work programme and prepared further Covid-19 specific reports and briefing papers to support public bodies and auditors respond to the pandemic.

2. Much of the audit work covered by this report was completed in the context of ongoing and changing pandemic restrictions during the 2020/21 audit year. The Auditor General for Scotland and Accounts Commission recognised that the safety and wellbeing of audit staff and staff in public bodies remained paramount and that auditors would need to take a pragmatic and flexible approach to their work in 2021 and 2022. They were also clear that audit quality should not be compromised.

## Overall conclusion

3. **The Audit Quality Framework (AQF) continues to identify good practice and areas to improve audit quality.** The framework uses a broad range of tools to assess audit quality including external and internal 'cold' reviews, 'hot' reviews, peer 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 audit
- good in accountancy firms however improvement is required in Mazars internal cold review scores
- improving in financial audit work carried out by Audit Scotland's Audit Services Group (ASG).

4. The improvement in quality scores provides a clear indication that high-quality standards are being achieved and that quality improvement plans are taking effect. Further work continues in some areas to ensure that all of the audit work meets the recognised standards expected by all our stakeholders and in particular by the Auditor General for Scotland and the Accounts Commission.

## Areas of good practice identified

5. **All of the performance audit and Best Value audits reviewed achieved the expected quality standards.** 2020/21 was the second audit year that the

performance audit methodology has been aligned to comply with the International Organisation of Supreme Audit Institutions (INTOSAI) standards. ICAS recognised the significant improvement in performance audit and Best Value assurance teams since 2017 for this type of audit engagement.

**6. Two of the financial audits reviewed were awarded the highest scores available by The Institute of Chartered Accountants of Scotland (ICAS).**

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

**8. For the 2020/21 audit year seven of the eleven ASG financial audits reviewed met the expected quality standard (64 per cent).** This is an improvement on 2019/20 results, when 36 per cent met the expected standard. This year's results demonstrate the effectiveness of the improvement actions taken by Audit Scotland over the past year. There is still work to do to meet the 80 per cent target and this will continue to be monitored and reported on in next year's QPAS report.

**9. The surveys of auditors 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.

**10. 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

**11. Audit staff within most 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 some evidence that the plans put in place by audit providers in response to these concerns have improved matters, but more time is needed to see if capacity building has been fully effective. There is 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.

**12. ASG should carry out a root cause analysis to understand the common findings and reasons behind their quality review gradings in 2020/21 and develop an action plan to address these.** This action plan should include sharing both the good practice identified through the quality reviews and the areas within the audits requiring improvement. ASG has invested in quality activity over the year, and it is recognised that some of the results of this will not be apparent until the next audit cycle. AQA will continue to monitor and report on this in the next annual report.

**13. Mazars should carry out a root cause analysis to understand the reasons behind its internal quality review gradings not meeting the expected standard over a three-year period and develop an action plan to address these.**

## Audit quality and appointments team action

**14.** 2021/22 is the final year of the current appointment round and audits subject to a quality review within this version of the AQF. The AQA team will undertake a review of the effectiveness of the current AQF with stakeholders and develop a new AQF for the start of the next audit cycle under the [2021 Code of Audit Practice](#). This follows a successful audit procurement exercise where six firms have been secured to carry out annual audit alongside ASG from 2022/23 to 2026/27.

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# Introduction

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

**16.** This report summarises AQA's assessment of audit quality carried out 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 2020/21 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

**17.** 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](#).

**18.** The audit profession remains under scrutiny and various reviews have taken place in recent years in response to high profile corporate failures. On 31 May 2022 the Business, Energy and Industrial Strategy Committee published its report [Restoring trust in audit and corporate governance](#) which summarises their response, following consultation on its March 2021 White paper on this subject, and its plans for action. The UK Government intends to prepare and publish a draft Bill. AQA will keep further developments under review for any implications for public audit in Scotland.

**19.** 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. It already operates many of the proposed controls 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 (current appointments were extended to six years due to Covid-19)

- independent fee-setting arrangements
- independent approval procedures for any non-audit services work
- a comprehensive Audit Quality Framework.

## Audit Scotland and appointed firms

**20.** Public audit is carried out 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.

**21.** Each appointed firm has its own arrangements for ensuring audit quality for financial audits. Appointed auditor transparency reports have been reviewed and show compliance with [International Standard on Quality Control 1](#). Transparency reports are included below for information about their audit quality arrangements.



Note: Azets are not required to produce a transparency report under regulations.

**22.** In April 2022, the FRC published its [Audit Firm Governance Code](#). The Code provides a framework for good governance practice against which firms that audit Public Interest Entities (PIEs) can be assessed and report. Its principal objectives are:

- to promote audit quality
- to ensure firms take account of the public interest in their decision-making, particularly in audit
- to safeguard the sustainability and resilience of audit practices and of firms as a whole.

**23.** This Code will initially only apply to the four largest UK audit firms. Three of these firms, Deloitte, EY and KPMG, are appointed to undertake public sector audit in Scotland and their transparency reports will need to be written in the future to comply with this new Code.



# Inputs

**24.** 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.

## Ethics

**25.** All auditors confirmed to their audited bodies and to AQA that they do not have any conflicts of interest. Cold reviews by internal teams and ICAS confirmed that all audits complied with the Financial Reporting Council's Ethical Standard to avoid any actual or perceived conflicts of interest.

## Non-audit services

**26.** Auditors may undertake some non-audit services for the bodies they audit. The Auditor General for Scotland and Accounts Commission have set out what non-audit work is permissible and how it should be approved in a [policy statement](#).

**27.** Auditors carried out permitted non-audit services to the value of £36k during the 2020/21 audits. This equates to 0.2 per cent of the total fees. This compares to £44.3k which equated to 0.2 per cent of total fees during 2019/20 audits.

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

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## Knowledge, experience and time

**29.** 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.

**30.** 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.

**31.** 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. Auditors continue to remain positive about the effectiveness of training that they receive.

**32.** However, there are still significant levels of concern among staff in some audit providers that the time and resources available to deliver a high-quality

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There is a strong culture of support for performing high-quality audit across all auditors.

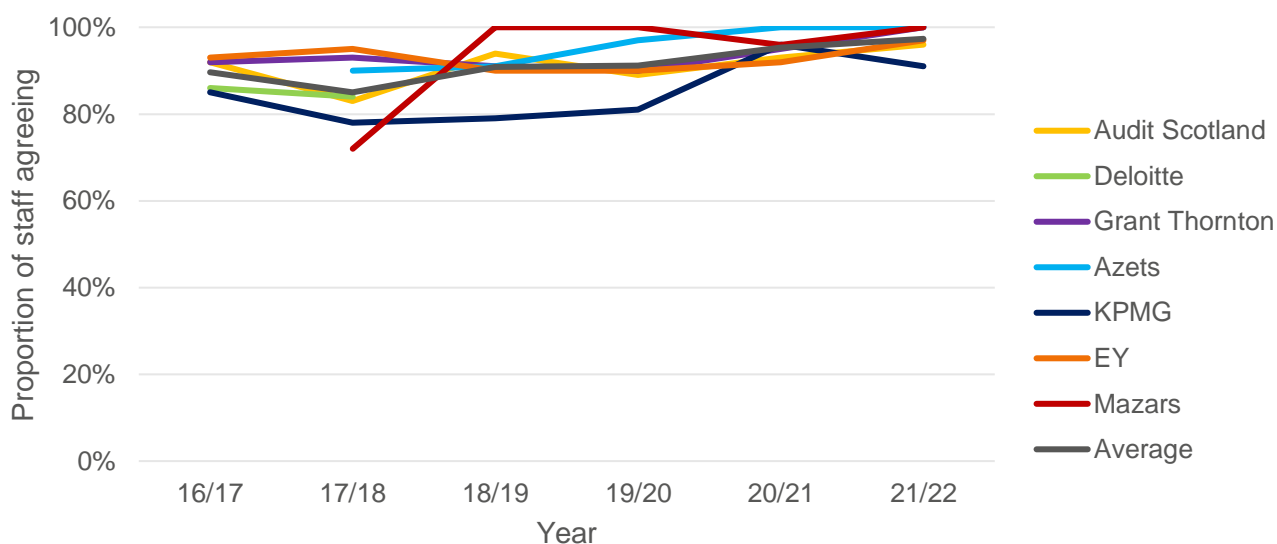
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audit are not sufficient. Actions taken to address this have only resulted in improved perception among staff in some firms, most notably there has been a consistent improvement in the last four years at Grant Thornton.

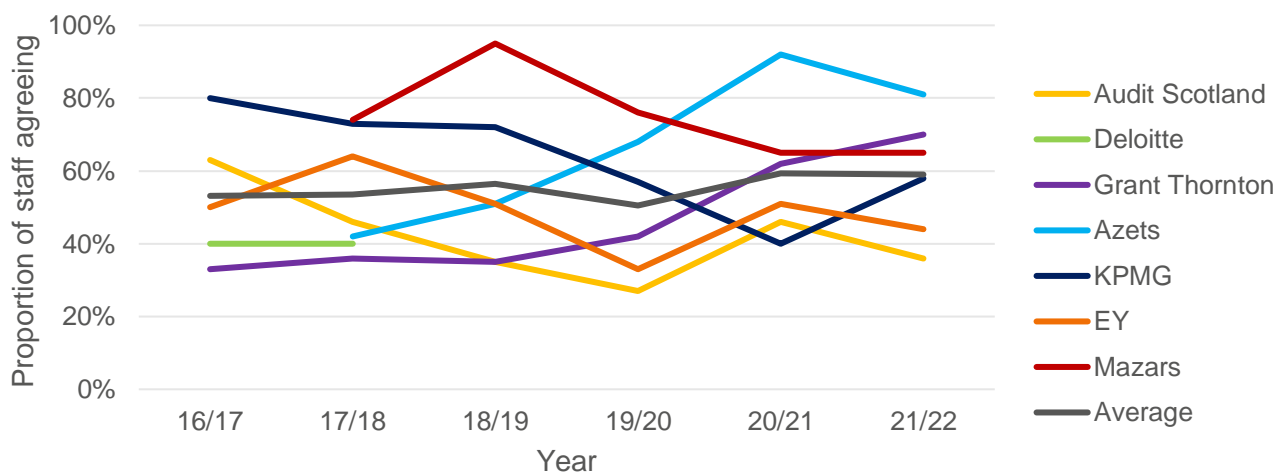
**33.** Audit Scotland and EY have returned declining results from what were already low relative prior year positions. Evidence from the audit profession suggests that there is a shortage of skilled and qualified audit staff available and that this capacity risk will need to be managed carefully. It is recognised that the building capacity programme in Audit Scotland has resulted in an increase in staff resources. However, staff are still feeling stretched in meeting audit quality requirements and deadlines.

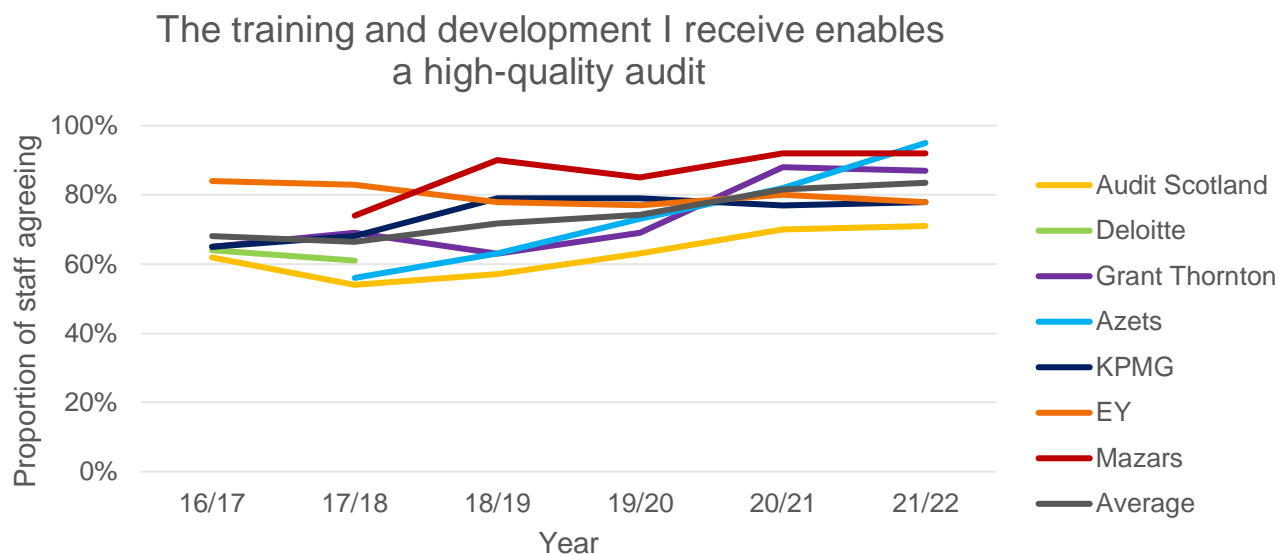
**34.** The survey results also show that staff continue to be supported to deliver high-quality audit work through training and development provision by audit providers despite the concern over resourcing.

I am encouraged to carry out a high-quality audit



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





#### Notes:

1. Azets and Mazars did not provide details in 2016/17. EY provided national data. Mazars provided national data for 2017/18 and local data since.
2. Deloitte changed their method of obtaining staff views. A survey was undertaken in the summer 2021 which returned positive results on Deloitte supporting their staff deliver high-quality audit with some areas for improvement identified.

## Qualifications

**35.** Audit work is carried out by appropriately trained and qualified individuals. The firms have 100 per cent of their staff either qualified or in training. Ninety-seven per cent of Audit Scotland staff working in financial audit are either CCAB (Consultative Committee of Accountancy Bodies) or Chartered Institute of Management Accountants qualified or in training for a CCAB qualification. A further three per cent have other qualifications in areas such as accounting or IT.

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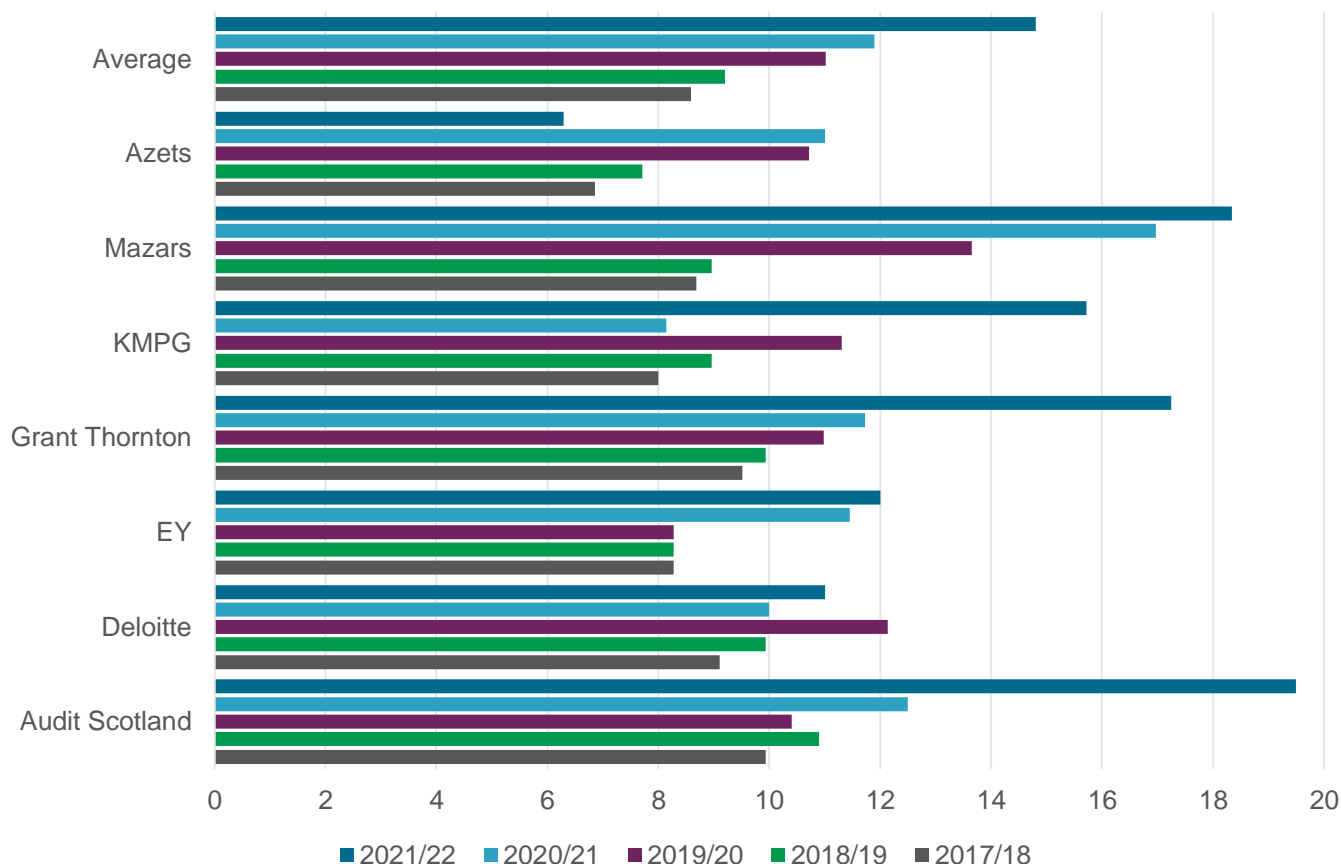
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**36.** Staff in the Performance Audit and Best Value group (PABV) have a variety of audit and research-related qualifications, all of which go towards supporting the delivery of high-quality audit work. Within PABV, 21 per cent (15 per cent in 2019/20) of staff are either CCAB qualified or in training for a CCAB qualification. This supports Audit Scotland's flexible 'one organisation' working. PABV staff also have several relevant postgraduate qualifications in support of their work.

## Training

**37.** 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.

## Training days



Notes: 1. Azets' total excludes wider Continuous Professional Development undertaken by staff.  
2. EY total excludes non-technical training and wider Continuous Professional Development undertaken by staff.

**38.** 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 15 days per member of staff (compared with 12 days in 2020/21).

**39.** 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.

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Considerable investment is being made in staff training with an overall average of 15 days per member of staff.

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## Audit process and quality control arrangements

**40.** 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.

**41.** All auditors are complying with ISQC (UK) 1. The ICAS 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. ICAS has now reviewed all audit providers and did not note any issues or matters for further consideration in this year's review.

**42.** Two important audit quality management standards [ISQM1 and 2](#) will replace ISQC1 for audits carried out after 15 December 2022. Work is underway at all audit providers to meet the requirements of these quality standards. AQA will review these standards and make any necessary changes as part of the update of the AQF in autumn 2022.

**43.** 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. 2020/21 was the second year that these audits were assessed for audit quality against compliance with INTOSAI standards.

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All auditors are complying with ISQC (UK) 1.

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# Outputs

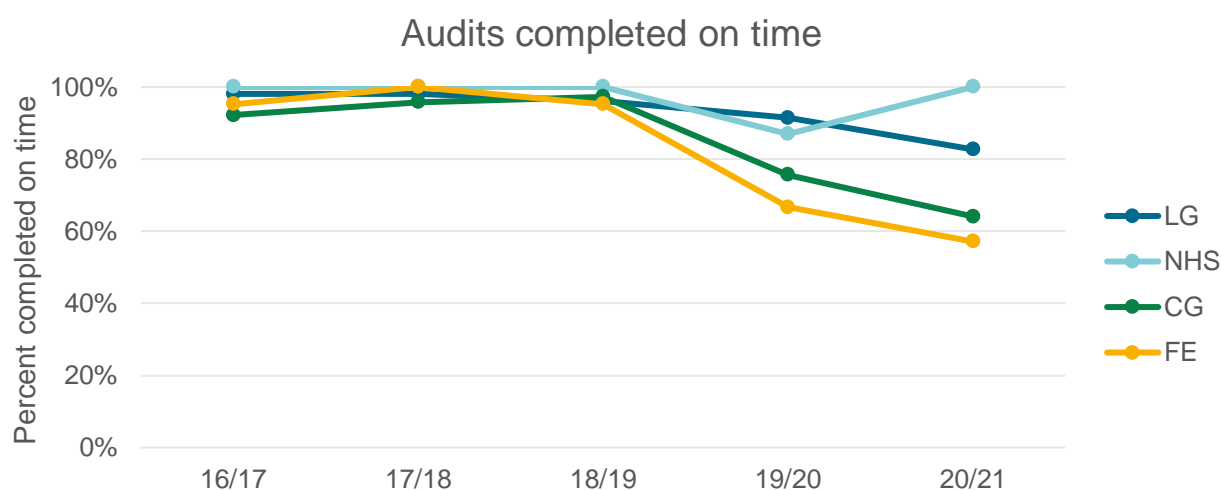
## Reporting

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

**44.** 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. Extended audit sign-off timetables were agreed for the second year, due to Covid-19, for NHS and local government bodies in 2020/201. These were:

- NHS – 30 September 2021, a three-month extension
- local government – 30 November 2021, a two-month extension.

**45.** Auditors' performance in meeting the targets for 2020/21 audits and the previous three years is shown in the graph below.



**46.** Auditors completed 76 per cent of their audits on time. This was a decline compared with the previous year's delivery performance of 83 per cent. It is clear that Covid-19 has had an ongoing impact on the ability of auditors to meet audit completion target dates. This is partly explained by the compressed 2020/21 audit year brought about by the previous year's deadline extension. All 2020/21 audit opinions were however signed off by 6 April 2022.

Auditors completed 76 per cent of their audits on time.

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

- the necessary rescheduling of audited body committee timetables (resulting in sign off being delayed beyond target dates)
- staff absences at audited bodies
- additional work required to be completed by the auditor due to emerging issues late in audit process
- reprioritising of audit work and resources agreed with audited bodies resulting in delays to commencement and completion of some audits.

**48.** While most audited bodies have coped well with the pandemic there were some sectors, particularly further education, that were affected more. This was primarily due to the smaller capacity in their finance teams to deal with staff absences.

**49.** Covid-19 also affected audit teams, audit timetables and reporting. Auditors worked hard to manage the impact on their audits. Common issues affecting audit timetables in 2021 included:

- assessment of new systems and internal controls set up by public bodies to deliver vital Covid-related funding
- review of accounting treatments for Covid-related expenditure and supplies, and work to support disclosures in annual reports and accounts
- access to audit evidence, including access to information and verification of assets
- the impact on productivity as auditors and audited bodies adapted to the changing circumstances and remote working.

## Modification of audit opinions

**50.** 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.

**51.** One auditor, Grant Thornton, modified their audit opinion by issuing a disclaimer opinion on the financial statements of two audited bodies for the 2020/21-year ends (two modifications in 2019/20). These were:

- **Scottish Canals** – a disclaimer of opinion was issued on the annual report and accounts. This was required as the auditor determined that

they had insufficient audit evidence, in relation to property, plant and equipment asset classification, to conclude that the accounts were not materially misstated or otherwise.

- **Scottish Environment Protection Agency** – a disclaimer of opinion was issued on the annual report and accounts. This was required as SEPA were unable to retrieve a significant amount of underlying financial records following a devastating cyber and ransomware attack.

**52.** Two audit opinions on the accounts were qualified by ASG. These were:

- **Non-domestic rating account** – the opinion was qualified as the receipts and payments were not in accordance with regulations which permit mid-year adjustments to councils' funding. During 2020/21, the Scottish Government adjusted NDR receipts and payments based on councils' mid-year estimates to support councils' cashflows during the Covid-19 pandemic. The adjustments made were greater than the 97 per cent of the initial estimates.
- **Social Security Scotland** – the auditor 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 £65.4 million. This expenditure was therefore not incurred in accordance with the applicable enactments.

**53.** There was one instance where the auditor reported by exception (two in 2019/20) as the local government significant trading operation (STO) failed to achieve the statutory objective to break even over a three-year period.

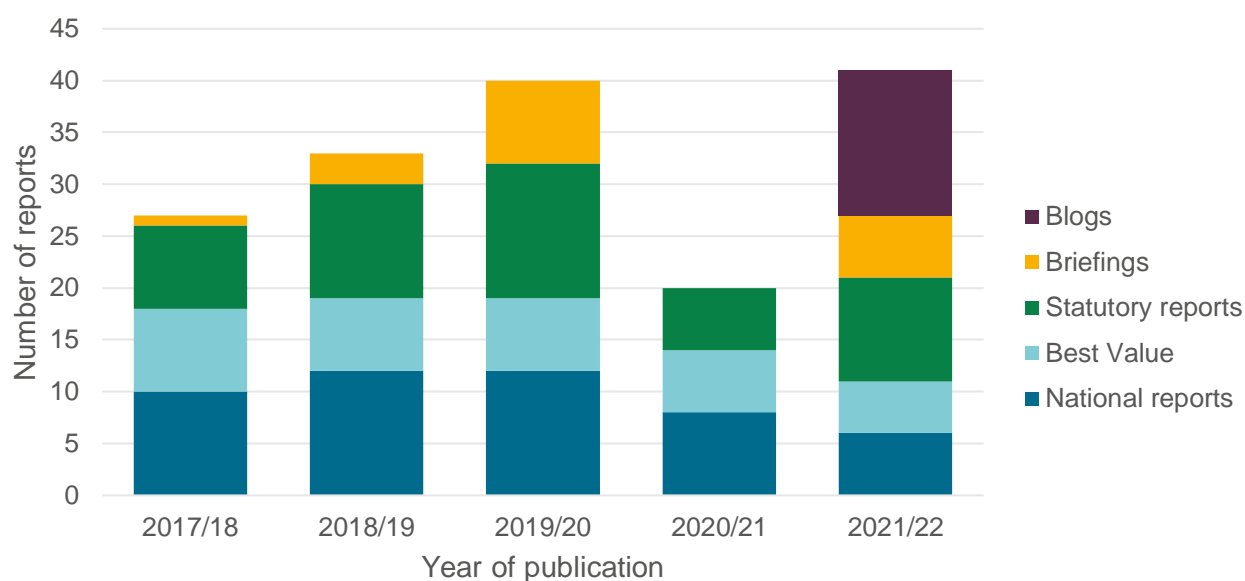
## Publication of performance audit and other reports

**54.** 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.

**55.** Following careful consideration of the impact of Covid-19 on the work programme, 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, focused and up-to-date and reflects the strategic priorities of the Auditor General and the Accounts Commission.

**56.** All performance audit, overview, and Best Value Assurance Reports (BVARs) were completed to planned timescales during 2021.






**57.** During 2021/22, Audit Scotland published six external briefing papers and 16 web-based outputs including the [Covid-19: Vaccination programme](#) and [Social care](#). 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

**58.** This section summarises the results of independent and internal cold reviews, using the Financial Reporting Council (FRC) grading system for all of the audit work. ICAS carried out the independent cold reviews and 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<sup>1</sup>

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>

Score	Standard	Description
2	 <p><b>Generally acceptable but a small number of improvements required</b></p>	<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	 <p><b>Some improvements required</b></p>	<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	 <p><b>Significant improvements required</b></p>	<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>

Note: 1. The FRC changed their grading system in 2021 from 1, 2a, 2b and 3 to 1, 2, 3 and 4. Prior year grades have been converted to the new system.

**59.** 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.

**60.** 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.

**61.** 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.

**62.** 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	60%	75%	<b>65%</b>	52%
Independent performance and Best Value audits	100%	100%	<b>100%</b>	63%
Internal financial audits	72%	93%	<b>79%</b>	81%
Internal performance and Best Value audits	100%	100%	<b>100%</b>	75%

Note: 1. 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.

### Independent external reviews

**63.** Independent external assurance offers the highest level of assurance to stakeholders. ICAS provides the independent external assurance and has 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 four years.

**64.** ICAS assessed 75 per cent of 2020/21 financial audits reviews as good or generally acceptable but a small number of improvements required (1 or 2) compared to 50 per cent of 2019/20 financial audits.

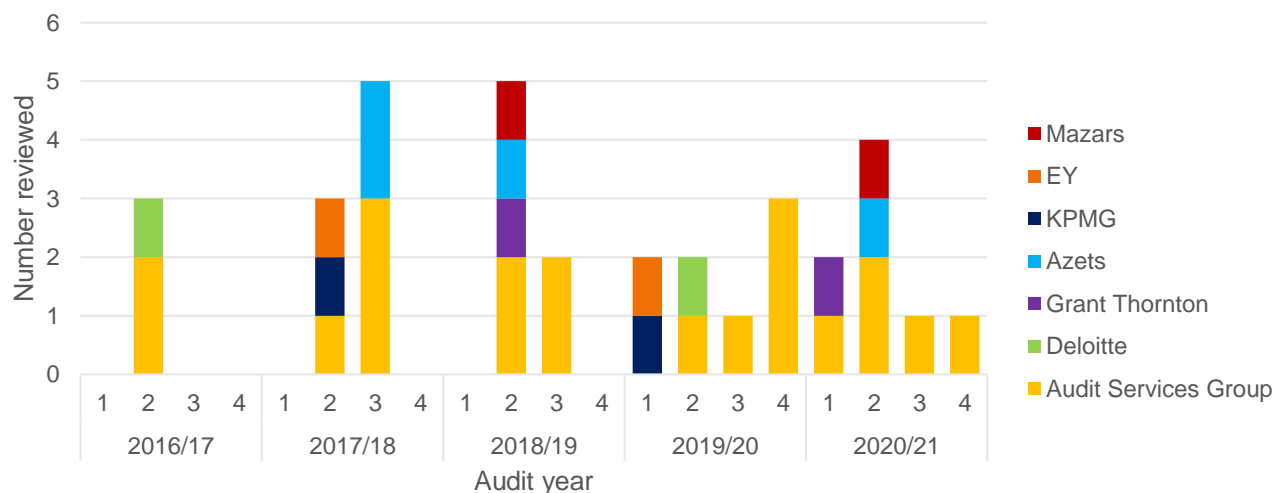
**65.** Over the last three years ICAS assessed 65 per cent (52 per cent previous year) of financial audits as good or generally acceptable but a small number of improvements required.

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

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## ICAS inspection results: Financial audits



**66.** These results show an improvement on the 2019/20 ICAS inspections results.

### Audit Services Group

**67.** ICAS awarded one ASG financial audit a 1 grading for the first time since ICAS inspections have been carried out under the AQF in 2017. ICAS concluded that all sections of the files were comprehensive and the financial statement disclosures were well presented. Only one ISA (UK) breach, related to documentation, was identified on the file.

**68.** This is an important milestone for ASG. It provides evidence that the improvement plan put in place in 2021, in response to the 2019/20 cold review results, has been effective for some audits. The programme of hot reviews conducted by the internal quality team was a key feature of this improvement plan and clearly benefited this audit.

**69.** ICAS graded two other financial audits as grade 2 meeting the expected quality standards set.

**70.** Two audits failed to meet the expected standard. One was graded as a 3 and one was graded as a 4. Findings for these files included:

- file specific matters were considered to require more than 'limited' improvement in relation to the sufficiency of audit evidence, including that over accounting estimates and in relation to journals testing
- the file did not demonstrate full compliance with the ISA (UK) 600 requirement for the group engagement team to review the work performed by component auditor
- issues relating to engagement lead review
- omissions in the audit report

- insufficient audit evidence being obtained over material transactions and balances, including several significant audit risk areas.

**71.** It is important that ASG learns from and responds to all the cold review findings. ASG should continue to carry out a root cause analysis of the common findings and identify any factors that have impacted on the number and nature of findings noted. ASG should develop their improvement action plan to address these causes. It is important that good practices identified are also understood and shared widely to support ASG auditors in meeting the expected standards.

### **ICAS follow-up reviews on matters identified in previous years**

**72.** ICAS also carried out targeted follow-up work to determine the progress on recommended actions on two of the three ASG audits reviewed in 2019/20 which were graded as 'significant improvement required' (grade 4).

**73.** Audit Scotland has worked to address prior year matters. In some areas there is clear evidence of improvement. At one of the central government audits followed up by ICAS, all prior year points had been addressed. However, issues previously identified by ICAS have been identified again in this year's reviews, such as:

- Significant audit judgements in the selection of journals to review on four audits did not clearly address all relevant characteristics of fraudulent journal entries identified within the auditing standard.
- There was insufficient evidence retained of engagement lead supervision of audit fieldwork on one file which did not demonstrate direct review of the fieldwork conducted over critical areas of judgment and in response to all the identified significant audit risks.
- One file presented issues over the group audit approach which were consistent with matters identified on two files reviewed in the prior year.
- One file presented a small number of repeat and related ISA (UK) breaches from the full review of the file conducted in 2020/21:
  - a repeat ISA (UK) 500 breach over the existence of debtors
  - insufficient evaluation of the objectivity of a management expert.
- Analytical procedures conducted over payroll assertions that were not in full accordance with the auditing standard.

**74.** The follow up of prior year matters identified by ICAS suggests that the action taken by Audit Scotland to date has not yet fully addressed all the matters raised. Further, some of these earlier findings remained in a local government audit that had been previously graded as not meeting the expected standard by ICAS.

**75.** Audit Scotland should continue to act to support its auditors to consistently deliver audits at the expected audit standard.

## Private firms

**76.** For the last three years all private accountancy firm audits have been assessed by ICAS as meeting the expected quality standard being graded as 'good' or 'generally acceptable, but a small number of improvements required'.

**77.** Three firm's financial audits were reviewed by ICAS in 2020/21. All achieved the expected standard with Grant Thornton being graded as a 1 for the first time by ICAS and Azets and Mazars audits were both graded as 2.

**78.** For Grant Thornton, many positive points were noted across planning, fieldwork and completion stages of the audit and no ISA (UK) breaches were identified during the ICAS review.

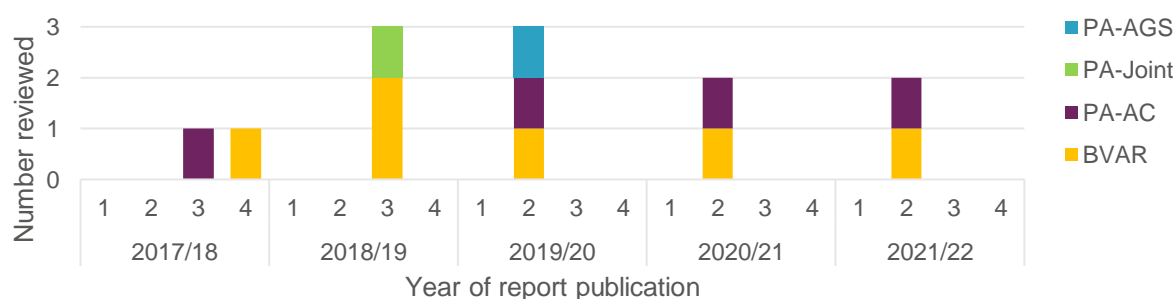
**79.** For Azets, ICAS concluded that there were no concerns regarding the sufficiency and quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed. The audit file was comprehensive and included a significant amount of information and supporting evidence. Only limited weaknesses in the documentation of audit work were identified.

**80.** For Mazars, many positive points were noted across planning, fieldwork and completion stages of the audit. There were only limited concerns regarding the sufficiency of audit evidence, and whether all relevant controls identified had been implemented during the year. The auditor had also not reported an emphasis of matter as a matter of material significance to the charity regulator, OSCR, which was a requirement of guidance issued.

**81.** The 2020/21 firm results continue to demonstrate the high quality of the private firm auditors appointed by the Auditor General for Scotland and the Accounts Commission to undertake public audit in Scotland.

## Performance audit and Best Value audits

ICAS inspection results:  
performance and Best Value audits



**82.** ICAS assessed one performance audit and one Best Value Assurance Report as meeting the expected standard (grade 2), with many positive points and only limited improvements required (same as 2019/20 reviews). The area of focus for further improvement relates to the documentation of audit evidence.

**83.** ICAS recognised the significant improvements in quality made by Performance audit and Best Value assurance teams since 2017 in undertaking this type of engagement.

### ICAS Audit Scotland summary

**84.** ICAS provided the following comments on the Audit Scotland audits that they reviewed:



#### ICAS 2021/22: AUDIT SCOTLAND EXTRACT FOR INCLUSION IN AUDIT SCOTLAND QUALITY REPORT

ICAS conducted a review of a sample of financial statement audits; one performance audit; and one BVAR engagement.

With regards the financial statement audits, there is evidence that some prior year findings and recommendations have been addressed, and the file grades indicate improvements have been made, however, the necessary level of audit quality has not been consistently achieved across all files.

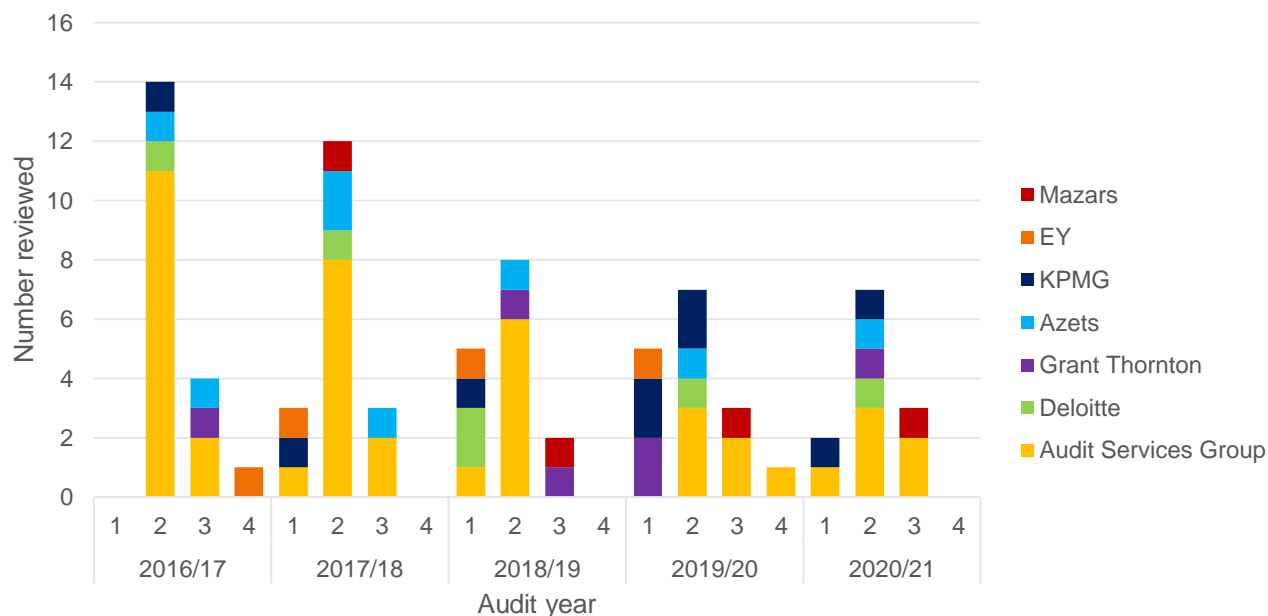
ICAS has recommended a range of actions that Audit Scotland may wish to consider taking to address the areas identified, including undertaking a root cause analysis of the common findings and any internal or external factors that have potentially impacted on the number and nature of these.

With regards the performance audit and BVAR engagements reviewed, it is noted that there has been significant and continuous improvement. While there are residual challenges in documenting audit work and the review process, a large number of positive points were identified.

### Internal cold reviews carried out by appointed auditors

**85.** Auditors reviewed 12 audits representing five per cent of 2020/21 audits (seven per cent in 2019/20). Each appointed firm is required under their appointment to conduct at least one internal review each year. Each Audit Director in Audit Scotland was reviewed at least once in the last three years.

### Internal inspection results: Financial audits



**86.** Reviewers did not identify any concerns with audit opinions for 2020/21. Reviewers assessed 75 per cent of 2020/21 financial audits as 'good' or 'generally acceptable but a small number of improvements required' (1 or 2, 75 per cent of 2019/20 financial audits).

**87.** Over the last three years reviewers assessed 79 per cent of the internal financial audits as 'good' or 'generally acceptable' but a small number of limited improvements required.

**88.** ASG internal reviews also had a no improvement score (grade 1) but a third of the audits reviewed did not meet the expected standard. This is an improvement on 2019/20 internal review findings. The overall findings were similar to ICAS, including the findings for one financial audit where both internal and ICAS reviews were carried out. This conclusion, arrived at independently, provides assurance that the internal quality review procedures are robust in Audit Scotland.

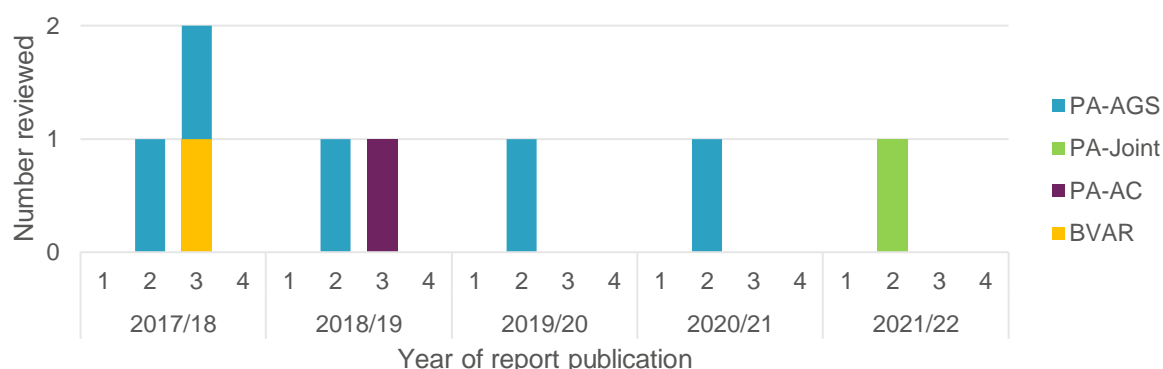
**89.** Internal reviews carried out by audit firms met the required standard except for Mazars which was graded a 3 for the third year in a row. This review was not specific to public audit in Scotland, it was submitted by Mazars to ensure an internal review was considered relating to 2020/21. Findings leading to this grade included various documentation issues, incorrect application of sample size calculator and a lack of evidence to support criteria for selection of journals to be tested. Mazars have agreed improvement actions, and these will be followed up during 2021/22.

#### Internal reviews carried out by PABV

**90.** Auditors carried out one internal cold review of a performance audit report published in 2020/21 (two in 2019/20).



### Internal inspection results: performance audits and Best Value assurance reports



### Hot reviews

**91.** Hot reviews are designed to meet the scope of Engagement Quality Control Reviews (EQCR) as set out in [International Standard on Quality Control 1](#). Hot reviews are carried out in financial audits before an audit opinion on the financial statements is signed to ensure that it is correct, and in PABV before a report is finalised. The results of hot reviews carried out by audit providers gives further evidence of audit quality.

**92.** Following 2019/20 ICAS reviews, ICAS recommended that ASG extend the independent hot file review and peer review processes to cover a wider range of audit engagements; and to cover the subsequent year engagements where a poorer file grade has been assigned.

**93.** ASG initiated hot reviews of financial audits in 2021 and these were delivered by a new quality assurance team in Professional Support. The team covered nine audits, including the three audits graded by ICAS as needing significant improvement in the prior year, and carried out a thematic review of the use of data analytics. This is a significant development in ASG audit quality arrangements which has helped address some of the quality concerns previously identified and has supported improvement in 2021.

### Improvement feedback for auditors

**94.** Auditors received detailed reports on each audit reviewed and are putting arrangements in place to address the findings from cold reviews. AQA will monitor how well the new arrangements improve audit quality as part of their regular meetings with auditors. Audit Scotland, working together with all auditors through their scheduled partner and sector meetings, will continue to share best practice to support improvements in the quality of public audit in Scotland.

## Annual audit reports

**95.** AQA reviewed a sample of annual audit reports to assess how effectively auditors were complying with the Code. The review found that there is a good level of compliance with the Code on auditor reporting.

**96.** The review identified an ongoing issue with some local government reporting by auditors on the wider scope of public audit. The Code requires the auditor report to conclude in the four wider scope dimensions and Best Value in local government sector. The Value for Money dimension had been replaced with a Best Value section in some ASG local government annual audit plans and reports, this does not therefore comply with the Code requirements. Some auditors are still not providing a conclusion on the effectiveness of arrangements at non council local government bodies to secure Best Value.

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There is a good level of compliance with the Code on auditor reporting.

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## Impact

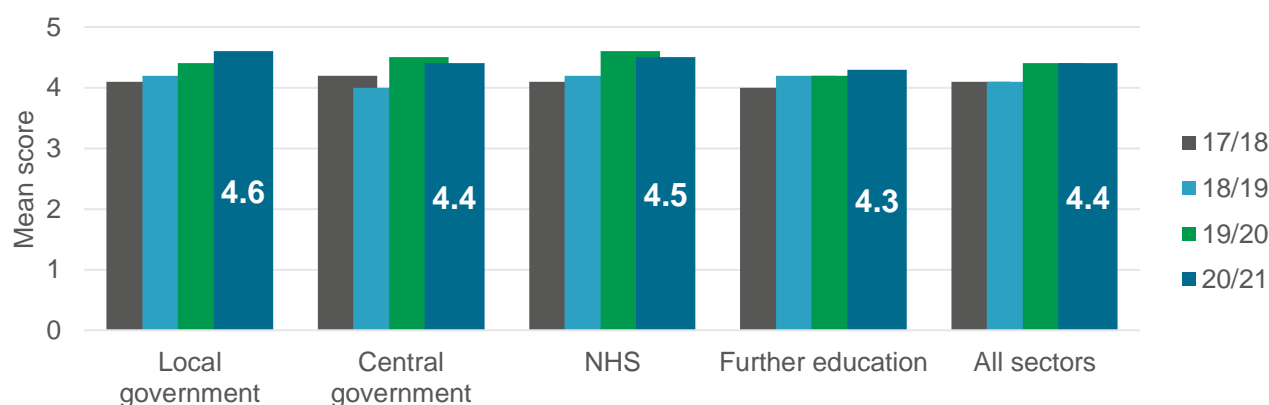
### Audited bodies' views on audit work

**97.** The Diffley Partnership was commissioned in 2021 to undertake the annual independent stakeholder feedback survey. It surveyed 568 individuals (549 in 2020/21) in audited bodies to gather feedback on the 2020/21 financial audits, Performance audits, overview reports and Best Value Assurance Reports published in the past year. There were 230 respondents (36 per cent, 35 per cent 2019/20). More chairs of central government audit committee were included this year, resulting in an increase in the population surveyed. 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

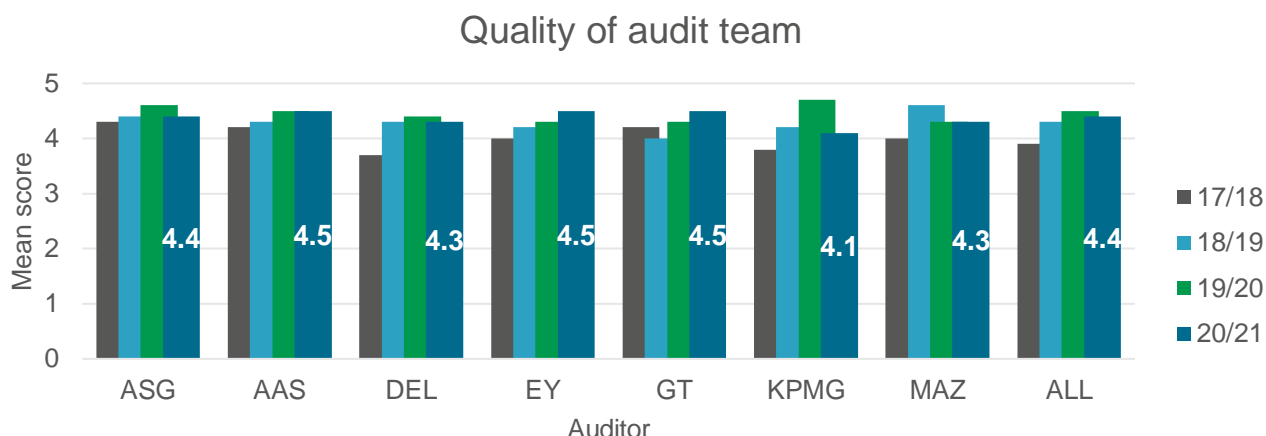
**98.** The conclusions on the usefulness of the annual audit are very positive. Stakeholders' perception of the usefulness of the audit remains high and are improving or remaining steady in most sectors compared to last year.

Usefulness of the annual audit overall



**99.** The coronavirus pandemic continued to impact on how auditors conducted their audits in 2020/21 with many audits largely being done remotely. Despite these challenges, the performance of the annual audit teams continued to score

highly. The vast majority, 91 per cent (the same as in 2019/20) thought that the annual audit team performed fairly or very well.



**100.** The changes in the way the annual audit was conducted led to no or very little face-to-face contact between auditors and the bodies which they audited this year. Two thirds of stakeholders (66 per cent) in 2019/20 believed that auditors were able to manage the audit remotely very well.

**101.** Stakeholders were offered an opportunity to reflect on how this year’s audit compared to last year’s audit. Given the positive reaction to the management of last year’s audit it is unsurprising that three in ten (30 per cent) stakeholders observed no change. Half of all stakeholders (50 per cent) believe the annual audit this year was better than last year, while a minority of stakeholders (6 per cent) believe the annual audit has worsened.

“The perception at the audit committee was that arrangements were much better established this year and there was less stress on achieving the reporting deadline.”

**Further Education**

“The regular communication arrangements that have been established have meant that all parties are able to support remote working.”

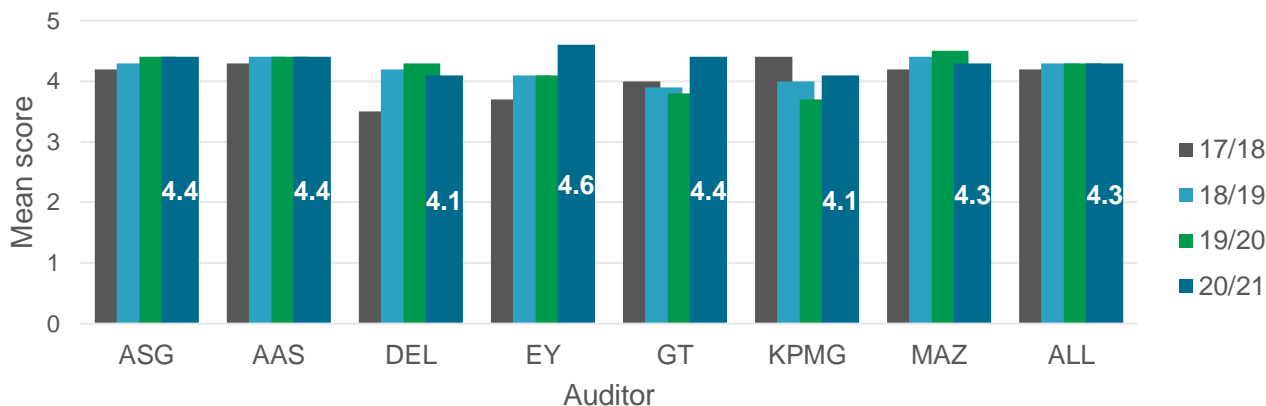
**Local Government**

“Swifter communication - auditors would call to discuss issues as they arose, rather than waiting until the end of a day. From a client perspective, it felt like we were more engaged with the audit.”

**Central Government**

**102.** Perceptions of the annual audit report are positive, with almost all (87 per cent) of stakeholders finding the annual audit report very or fairly useful, which is similar to last year (86 per cent).

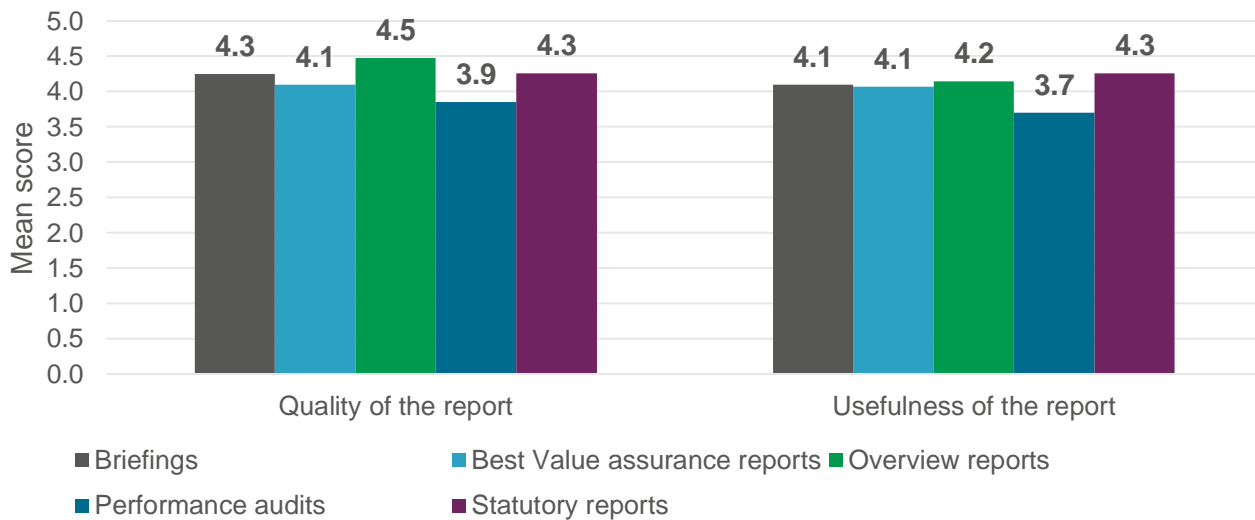
### Quality of annual audit report



### Performance audit and Best Value Assurance Reports

**103.** Audited bodies expressed positive views on the quality and usefulness of performance audits, overview reports, Best Value Assurance Reports and briefings. Perceptions of all reports increased slightly on the previous year.

### Quality and usefulness of performance audit and Best Value assurance reports



### Adding value

**104.** 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.

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

- 
- Supporting enhanced transparency and understanding
  - Providing technical views on accounting and reporting issues
  - 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
  - Sharing specialist reports with audited bodies such as the impact of Covid-19

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# Areas for improvement and future focus

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**106.** 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.

**107.** Auditors have made improvements since the 2020/21 Quality of public audit in Scotland report:

- ASG and Grant Thornton achieved an ICAS assessment of no areas for improvement required.
- All auditors are now reporting on how they added value through their audit work.

**108.** 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 world-class public audit. AQA will monitor improvement areas identified this year.

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

- Ensuring that audit evidence obtained is significantly improved and that there is documented evidence of Engagement Lead review and direct review of the fieldwork conducted over critical areas of judgment and in response to all of the identified significant audit risks.
- EQCR process is documented on a timely basis, the process only considered some of the significant audit risks identified over the financial statements and was not considered to fully meet the requirements set out in the Audit Scotland Audit Guide, as informed by ISQC(UK)1.
- Consideration of the approach adopted by ASG in documenting this type of hot file review, with ISA (UK) 220 providing relevant commentary on the nature and extent of documentation that may be appropriate.
- Significant audit judgements in the selection of journals to review on audit files did not clearly address all relevant characteristics of fraudulent journal entries identified within ISA (UK) 240.
- The general approach of selecting a pre-set sample size of journals, typically on a random sample basis, in advance of detailed review being

conducted, was not considered to provide sufficient appropriate audit evidence in response to the significant risk from management override.

- ASG considering its approach to the ISA (UK) 600 requirement to review the work of component auditors. The [FRC Staff Guidance Note 02/2018 -Group Audits](#) provides useful reference. It may be beneficial to set out more clearly:
  - A process for determining whether a component is ‘significant’ under the terms of ISA (UK) 600, along with setting out the implications this categorisation has for audit planning, fieldwork and completion
  - A process for determining and documenting how and where sufficient appropriate audit evidence will be obtained over all material group transactions and balances and
  - Potential approaches to be taken by the group engagement team where components are considered: Significant and Material; Material but Not Significant; and Not Significant and Not Material.
- Performance audit - there remains a risk that documents could be added to, amended or removed from the engagement file after the date of report publication. Audit Scotland may wish to consider the ISSAI requirements with regards audit documentation and quality control in this regard.
- BVAR engagements - there remains a risk that superfluous documents are retained on the audit file which reduce the team’s ability to demonstrate all key audit evidence has been fully considered. Teams may wish to consider how schedules are documented in future, to set out more clearly the nature and extent of audit consideration applied.

## Issues in the auditing profession

**110.** The ongoing impact of the Covid-19 pandemic on 2020/21 audits contributed to auditors not meeting all output targets. The FRC has [highlighted](#) that this should not undermine the delivery of high-quality audits. Audits should continue to comply fully with the required standards. In current circumstances, additional time may be required to complete audits and it is important that this is taken, even at the risk of delaying reporting.

**111.** There is increasing evidence that there are recruitment difficulties in the auditing profession due to a shortage of skilled and qualified audit staff available. This, together with the perceived unattractiveness of auditing compared to other accounting disciplines, presents a current and future risk to the delivery of high-quality public audit in Scotland.

**112.** The FRC published two reports in November 2021 relevant to improving the quality of audit. The [Developments in Audit](#) report summarises the key issues facing the auditing profession and lists these as:

- Regulatory reform and resilience

- Improving audit quality
- Covid-19 and beyond
- Developments in auditing, assurance and ethical standards
- Enforcement.

**113.** To support auditors and audit firms meet these issues the FRC published the report [What Makes a Good Audit](#). This report provides valuable guidance and insight on:

- **Key attributes of a good audit in which the FRC identifies high-quality audits as those that:**
  - provide investors and other stakeholders with a high-level of assurance that financial statements give a true and fair view
  - comply with both the spirit and the letter of auditing regulations and standards
  - are driven by a robust risk assessment, informed by a thorough understanding of the entity and its environment
  - are supported by rigorous due process and audit evidence, avoid conflicts of interest, have strong quality management, and involve the robust exercise of professional judgement and professional scepticism
  - challenge management effectively and obtain sufficient audit evidence for the conclusions reached; and
  - report unambiguously the auditor’s conclusion on the financial statements.
- **Key attributes of a high-quality audit practice** where it discusses:
  - ISQM 1 and the new approach to quality management at the firm level that emphasises the responsibility of firm leadership for proactively managing quality.
  - the Key Components of a System of Quality Management.

## AQF development








**114.** AQA, together with stakeholders, will undertake a full review of the AQF in autumn 2022. This review will examine the best practice examples identified from these FRC reports and consider:








- The implications for audit quality arising from the new audit quality standards.



- The changes arising from the [2021 Code of Audit Practice](#) including the enhanced local auditors responsibility for annual Best Value reporting.
- How to bring more transparency to audit quality and reporting?
- How quality reviews of individual auditors are reported?

# Appendix 1

KPI	Target	Actual	Conclusion
Value of non-audit services carried out during the audit year.  (Paragraphs 26 to 28)	Steady or declining value	£36k representing 0.2 per cent of total fees during the 2020/21 audits (£44.3k representing 0.2 per cent of total fees during 2019/20 audits)	
Percentage of audit providers confirming compliance with ethical guidance.  (Paragraph 25)	100%	100%	
Percentage of audit staff with appropriate qualifications and in training.  (Paragraphs 35 to 36)	100%	100% for private firms 100% for Audit Scotland	
Number of training and development days delivered per member of staff.  (Paragraphs 37 to 39)	Steady or increasing	15 days (12 days 2019/20)	
Percentage of cold reviews showing good compliance with auditing standards.  (Paragraphs 58 to 90)	80% Cumulative over 3 years	ICAS financial audits: 65% Internal financial audits: 75% ICAS PABV audits: 100% Internal PABV audits: 100%	
Percentage of audits completed on time.  (Paragraphs 44 to 49)	95%	76%	
Percentage of audits with material prior period adjustments due to error.  (n/a)	Less than 10%	7.1%	

KPI	Target	Actual	Conclusion
Percentage of performance audit and Best Value Assurance Reports published as planned.	90%	100%	
(Paragraphs 54 to 57)			
Perception of the usefulness of the audit overall	4/5	4.4/5	
(Paragraphs 97 to 102)			
Perception of the appropriateness of coverage of (not asked in 2020/21 due to shortening of survey)			
i. Governance and accountability	4.0	n/a	
ii. Financial management	4.0	n/a	
iii. Financial sustainability	4.0	n/a	
iv. Value for money	4.0	n/a	
v. Best Value (LG only).	4.0	4.25	
(Paragraphs reference: n/a)			
Perception of the quality of:			
i. Overview reports	4.0	4.5	
ii. Performance audits	4.0	4.4	
iii. BVARs	4.0	4.1	
Perception of the impact of:			
i. Overview reports	4.0	4.2	
ii. Performance audits	4.0	4.3	
iii. BVARs	4.0	4.1	
(Paragraph 103)			
Staff survey results on:	Steady or increasing		
a) I am encouraged to carry out a high-quality audit		97% (95% 2020/21)	
b) The time and resources available to me enables the delivery of a high-quality audit		59% (59% 2020/21)	
c) The training and development I receive enables a high-quality audit.		84% (82% 2020/21)	
(Paragraphs 29 to 34)			

# Quality of public audit in Scotland

Annual report 2021/22

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