

Transparency and quality

Annual report 2014/15



Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Key messages	4
Introduction	5
Transparency	7
Vision, principles and themes	7
Governance and structure	8
Finances	10
Quality	11
The components of a quality audit	11
Quality arrangements	11
Sources of quality assurance	13
Results of quality assurance activity	14
Developments in audit quality arrangements	27
Conclusion	30
Appendix: Quality arrangements	31
Glossary	36

Key messages

- Audit Scotland's Corporate Plan priorities include commitments to improve the quality of audit and focus audits on where they add most value. Our Quality Framework, which was revised this year to reflect international initiatives on the quality of audit, continues to provide an effective principle-led structure for our quality control and quality monitoring activities.
- The quality control arrangements in place across Audit Scotland continue to develop to drive us towards our vision of being a world-class audit organisation.
- The results of quality monitoring activities this year enable us to provide assurance to the Auditor General and the Accounts Commission that the quality of audit work carried out during 2014/15 has remained high.

Introduction

1. Audit Scotland supports the Auditor General and the Accounts Commission to ensure public money in Scotland is used properly, efficiently and effectively. It does this by carrying out financial, performance and Best Value audits across the public sector in Scotland whose total annual spend is over £40 billion. In carrying out this work Audit Scotland seeks to be transparent in its governance and operations and to produce consistent high-quality audits.
2. Audit Scotland is a statutory body established under the Public Finance and Accountability (Scotland) Act 2000 to carry out audits and examinations for the Auditor General and the Accounts Commission. The Auditor General audits or appoints the external auditor of most public bodies in Scotland except for local authorities where the Accounts Commission is responsible for securing audits.
3. The 2013/14 audits completed in the year cover around 200 organisations including:
 - 74 central government bodies (Scottish Government, non-departmental public bodies, agencies and others)
 - Scottish Parliamentary Corporate Body
 - 23 NHS bodies
 - 32 councils (including 125 related charities' opinions)
 - 11 local government pension funds
 - 33 joint boards and committees
 - 21 further education colleges
4. Audit Scotland's Quality Framework, which sets out the high level principles underpinning the quality of its work, was updated in 2015 and took account of a number of national and international initiatives and publications including the International Audit and Assurance Standards Board's *A Framework for Audit Quality* (2014) and the Financial Reporting Council's *Professional Scepticism* (2012). The Framework requires the annual quality report to take the form of a *Transparency and Quality Report* in line with best practice for auditors of public listed entities in the private sector.
5. This report therefore combines information on the overall structure and governance of Audit Scotland (**transparency**) with information on the arrangements in place for producing high quality work, by Audit Scotland and the appointed firms, in the services provided to the Auditor General and the Accounts Commission (**quality**).



Transparency

Vision, principles and themes

Vision

6. Audit Scotland's Corporate Plan sets out our vision to be a world-class audit organisation that improves the use of public money. It sets out our key function as providing independent assurance to the people of Scotland that public money is spent properly and provides value for money.

Principles

7. Audit is at the heart of the work carried out by Audit Scotland staff. The principles which guide this work are set out in the Code Of Audit Practice:
 - Auditors are independent of the organisations that they audit.
 - Public audit is wide in scope to reflect the accountabilities attached to the use of public money.
 - Audits are based on comprehensive risk assessment.
 - Reports are made public.
 - Auditors work in partnership with each other.
 - Auditors work collaboratively with other scrutiny bodies.
 - Auditors work as catalysts to help public bodies improve their performance.
 - Audits are carried out to a high standard using skilled and experienced staff.
 - Audits are informed by assessment of costs and benefits and achievement of Best Value or value for money.
 - Auditors balance confidentiality and information security with public accountability and freedom of information.

Themes

8. Public Audit in Scotland, a joint publication from the Auditor General, the Accounts Commission for Scotland and Audit Scotland, sets out the common themes that will inform our work:
 - Independence and impartiality to underpin effective audit.
 - Consideration of strategic issues across the public sector to support learning and continuous improvement.
 - Understanding of the environment in which public bodies operate to focus audits on where they will add most value.
 - Openness in our work to help bodies understand more about our methods and processes.

Governance and structure

Governance

9. Effective governance is vital to Audit Scotland's long-term sustainable success. Audit Scotland aims to apply the same high standards of governance and operations to ourselves as we recommend for others.
10. The Public Finance and Accountability (Scotland) Act 2000 established Audit Scotland as a corporate body to provide assistance and support to the Auditor General and the Accounts Commission. The Board of Audit Scotland supports the Auditor General and the Accounts Commission in their statutory responsibilities and oversees how Audit Scotland manages and uses resources but is not involved in individual audit judgements.
11. The statutory arrangements provide for effective governance of Audit Scotland while preserving the independence of the Auditor General and the Accounts Commission in their statutory roles. Independent audit judgements are made by the Auditor General, the Accounts Commission, the Controller of Audit and appointed auditors.
12. Audit Scotland is accountable to the Scottish Parliament for its use of resources through the Scottish Commission for Public Audit (SCPA), a parliamentary body whose membership includes MSPs from all main parties, which scrutinises Audit Scotland's budget and annual report and accounts. The SCPA also appoints an external auditor.
13. The Act provides for a five-member board which has overall responsibility for the strategic direction of the organisation and for approving significant policies. The Board members during 2014/15 were:
 - an independent chair, John Maclean (from October 2014, Ronnie Cleland to September 2014), and two independent non-executive members, Ian Leitch and Heather Logan (from September 2014), who are appointed by the SCPA
 - the Auditor General, Caroline Gardner who is also the Accountable Officer for Audit Scotland. She was appointed by the Crown for a single fixed-term of eight years from 1 July 2012
 - the Chair of the Accounts Commission, Douglas Sinclair. The Accounts Commission is responsible for securing local authority audits and is independent of local government; the Chair and Commission members are appointed by Scottish Ministers.
14. The Board is supported by two committees:
 - An audit committee which supports the Board by reviewing the internal controls, risk management processes and governance arrangements. The committee oversees the appointment of internal auditors and considers the annual report and accounts and reports from both internal and external auditors. Heather Logan was co-opted to the committee prior to her appointment to the Board.
 - A remuneration and human resources committee which supports the Board in determining the remuneration of management team members and the remuneration

policies for all staff. The remuneration of the Auditor General is set by the Scottish Parliamentary Corporate Body. The remuneration of the independent board members is determined by the SCPA.

15. A management team oversees Audit Scotland's day-to-day operations. The members at 31 March 2015 were:
- Caroline Gardner, Auditor General
 - Diane McGiffen, Chief Operating Officer, who chairs the management team meetings and is responsible for Audit Scotland's internal operations and business performance
 - Russell Frith, Assistant Auditor General, who is responsible for the external strategic and development work of financial audit, as well as auditing and accounting standards, technical support and quality assurance. He advises on the appointment of auditors, the oversight of audit quality and provides guidance and advice on accounting, auditing and ethical matters to auditors. He acts as Audit Scotland's Ethics Partner and is supported by the Audit Strategy Group
 - Fraser McKinlay, Director of Performance Audit and Best Value, who is also Controller of Audit and leads the Performance Audit and Best Value Group (PABV)
 - Fiona Kordiak, Director of Audit Services, who leads Audit Services Group (ASG) which provides in-house audit services to the health, central government, further education and local government sectors.

In addition, Lynn Bradley, Director of Corporate Performance and Programmes, who was responsible for key areas of development including corporate knowledge and information management and corporate performance reporting, until June 2014.

Operational Structure

16. Audit Scotland's operational structure is based around four main business groups:
- ASG is responsible for carrying out audits of public bodies falling within the remit of the Auditor General and the Accounts Commission on a five year appointment cycle.
 - PABV is responsible for providing a range of audit services to the Auditor General and the Accounts Commission. These include a programme of performance audits, Best Value (BV) audits of local authorities, audits of Community Planning Partnership (CPP), the preparation of statutory reports (S102 or S22), sectoral overview reporting and scrutiny improvement activity (including shared risk assessments).
 - Audit Strategy is responsible for audit procurement, technical guidance and support, reviewing and reporting on audit quality, coordinating the National Fraud Initiative exercise in Scotland and conducting benefits performance audits of local government.
 - Corporate Services is responsible for supporting Audit Scotland's principal functions with communications and media, finance, information services, human resources and organisational development, facilities management and business support.

17. The Auditor General and the Accounts Commission appoint the external auditors of public bodies in Scotland for periods of five years with the current appointments ending with the 2015/16 audits. Appointments to carry out annual audits are split between ASG staff and seven private firms; the latter carrying out just over a third of these engagements by value. The Appendix contains a break-down of sector appointments by firm. Performance and Best Value audits are generally carried out by Audit Scotland staff with assistance from appointed auditors or external experts where appropriate.
18. Audit Scotland has a workforce of 266 whole-time equivalent staff, over half of whom are in ASG. Staff are mostly based at offices in Edinburgh, Glasgow and Inverness. All staff complete annual "Fit and Proper" forms to ensure that conflicts of interest are avoided.

Finances

19. Audit Scotland submits annual budget proposals to the SCPA for consideration. The SCPA takes evidence in public on the proposals and then makes a report to the Scottish Parliament as part of the annual Budget Act approval process.
20. Audit Scotland's activities are funded through direct funding from the Scottish Consolidated Fund (2014/15: £7.1 million) plus audit fees paid by the audited bodies, bank interest, finance and miscellaneous income (2014/15: £17.4million).
21. Audit Scotland embarked on a four-year plan in 2010 to reduce the cost of audit by at least 20% in real terms by 2014/15. Audited bodies have received a cumulative real term reduction in fees of 23.5% over the period to the end of the 2013/14 audit year.

Quality

The components of a quality audit

22. In keeping with our vision to be a world-class audit organisation, our Quality Framework takes account of the five elements of a quality audit set out in the International Audit and Assurance Standards Board's (IAASB) *A Framework for Audit Quality*. The Framework states that:

A quality audit is likely to have been achieved by an engagement team that:
<ul style="list-style-type: none"> Exhibited appropriate values, ethics and attitudes
<ul style="list-style-type: none"> Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work
<ul style="list-style-type: none"> Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards
<ul style="list-style-type: none"> Provided useful and timely reports and
<ul style="list-style-type: none"> Interacted appropriately with relevant stakeholders

Source: IAASB, *A Framework for Audit Quality, Key Elements that Create an Environment for Audit Quality*, IFAC, February 2014, Para 2

23. Our Quality Framework sets out how these important components are relevant to Audit Scotland's work. Key quality appraisal activities such as biennial audit quality surveys issued to audited bodies for feedback and internal or peer reviews of our work provide assurance on these criteria. The remainder of this report describes in more detail how Audit Scotland demonstrates these elements across its business groups through the quality control arrangements which have been put in place and the results of quality assurance activities during the year.

Quality arrangements

24. Our Corporate Plan confirms our commitment to operate to the highest ethical and professional standards and our aim to maximise the value of the audit and support improvement. This commitment is embedded in our Quality Framework which sets out the following principles:
- Quality is the responsibility of everyone in Audit Scotland.
 - Our approach to quality will drive continuous improvement across Audit Scotland.
 - Quality will be assessed in terms of outputs, outcomes and impact, as well as inputs and processes.

25. The overall quality framework is shown in **Exhibit 1** below:

Exhibit 1: Audit Scotland Quality Framework



Source: Audit Scotland

26. Getting it right first time is key to Audit Scotland being a high quality, efficient and effective audit organisation and requires that quality is embedded in all our thinking, our processes and our activities. Each member of staff in Audit Scotland has a responsibility to get it right first time, and needs to demonstrate a commitment to quality in everything they do.
27. Quality control refers to quality management during an audit or project. It may involve peer review and in some cases external input. There are four principal characteristics of quality control:
- Review at regular intervals by staff internal or external to the organisation.
 - Regular internal challenge sessions.
 - Formal assessment of adherence to local quality processes.
 - Proportionality of quality control activities to maximise the quality and efficiency of work and allow staff to retain a sense of ownership.
28. Quality monitoring ensures that all types of audit work are reviewed and lessons are learned and used to improve processes and methodologies. The activities undertaken as part of quality control and quality monitoring are described in more detail in the sections below on quality arrangements and results of quality control activity.
29. The diagram below summarises the respective responsibilities within Audit Scotland for the key strands of audit quality:

Audit quality



Board

Setting the tone at the top
Quality framework



Audit Strategy

Oversight of quality arrangements
Surveys of audited bodies
Monitoring of firms' arrangements



Business groups and firms

Quality control arrangements
Quality monitoring of audits



Audit leads

Quality control of individual audits

30. Business groups are responsible for establishing the quality arrangements for their activities including the processes for getting it right first time, quality control and quality monitoring. Key documents are available to staff on the Audit Scotland intranet.
31. The Corporate Quality Group, with representatives from each business group, supports the maintenance of the Quality Framework and the preparation of this Transparency and Quality Report. It coordinates and shares best practice in quality monitoring and supports each business group's quality control and monitoring procedures. These arrangements are described in detail in the Appendix to this report.
32. The following sections of the report outline the results of quality control and monitoring activity during 2014/15 and developments in audit quality arrangements taking place in each business group. We are satisfied that the internal quality control systems described more fully in the appendix are operating effectively.

Sources of quality assurance

Assurance over the quality of audit is obtained from a variety of sources, which when combined provide reasonable assurance over the quality of audit work. The sources include internal arrangements, internal checks and external sources. These are set out in [Exhibit 2](#) on the basis of the Quality Framework. The operation of the assurances within the two principle business groups are mapped for ASG at [Exhibit 3](#) and PABV at [Exhibit 8](#), with further detail on their operation in the [Appendix](#).

Exhibit 2: Sources of assurance



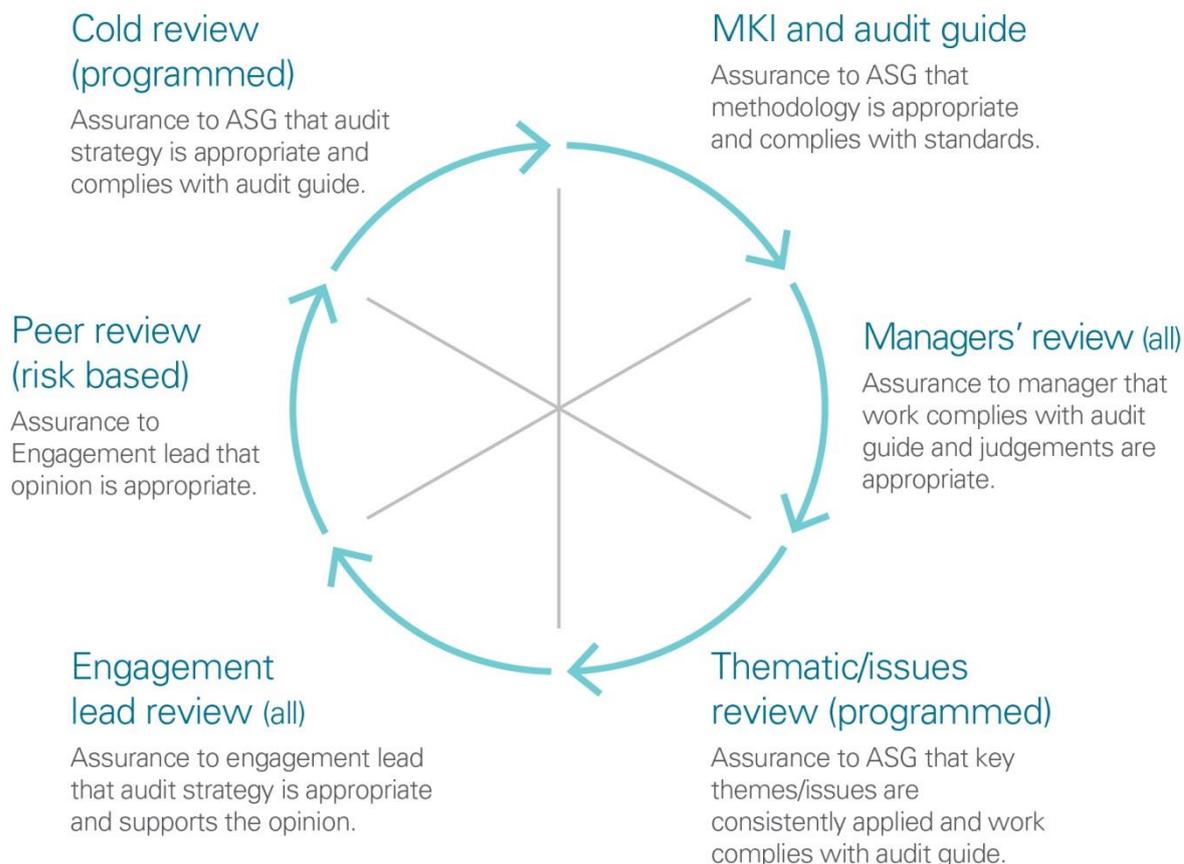
Source: Audit Scotland

Results of quality assurance activity

Audit Services

33. ASG's quality management processes are fully documented in the audit guide embedded in MKI, which is used for all audits. **Exhibit 3** provides an overview of these arrangements, which are expanded upon in the **Appendix**.

Exhibit 3: Overview of ASG's quality management arrangements



Source: Audit Services Group

Thematic reviews

34. During 2014/15, ASG responded to the Financial Reporting Council (FRC) report on Materiality and the internal report by the Assistant Auditor General. For the most part this reinforced ASG's approach to materiality, although clearly trivial thresholds have been revised and planning and reporting templates were amended to increase disclosures to audited bodies. ASG staff were updated on changes made at the Annual Audit Update in November 2014.

Engagement lead reviews

35. All audits received engagement lead reviews, which confirmed that the audits had been carried out in accordance with the audit guide and quality arrangements.

Peer reviews

36. **Exhibit 4** shows the number of peer reviews planned and completed. The nine peer reviews carried out on 2013/14 audits were completed in a timely manner and confirmed that the audit opinions were appropriate.

Exhibit 4: Number of peer reviews planned/delivered each year

2012/13	2013/14	2014/15
10	9	8

Source: Audit Services Group

Cold reviews

37. **Exhibit 5** shows the number of cold reviews undertaken and planned during the current five year appointment.

Exhibit 5: Number of cold reviews planned/delivered each year

2011/12	2012/13	2013/14	2014/15	2015/16
8	10*	8	7	8

*Includes 6 cold reviews carried out by ICAS

Source: Audit Services Group

38. The number of these cold reviews undertaken by the internal team is affected by the incidence of biennial external reviews undertaken by ICAS. The Institute of Chartered Accountants of Scotland (ICAS) quality monitoring team completed their second biennial assessment covering the 2012/13 audit year. The scope of their work was to:
- cold review a sample of six audits to assess the quality of audit work and compliance with the International Standards on Auditing (ISAs) and Ethical Standards
 - review financial statement disclosures for the audited entities sampled
 - review Audit Scotland's progress against the findings contained within the report issued in relation to the outcomes from their first assessment of 2010/11 audits.
39. The work of ICAS provided positive assurance, identified a relatively small number of areas for improvement and confirmed that previous recommendations had been implemented. ASG remains committed to procuring external review of audit work on a biennial basis.
40. Further external assurance is obtained from the Northern Ireland Audit Office (NIAO) and the Wales Audit Office (WAO) who have undertaken four of the 20 reviews since 2011/12.

41. The reviews of 2013/14 audits identified that all audits were complying with ISAs in all material respects. The following areas for improvements were identified in a small number of audits:
- Documentation of reliance on internal audit.
 - Rationale for use of materiality level and timeliness of reassessment.
 - Tracking of audit risks throughout the life of the audit.
 - Timeliness of file review and closure.

Appointed firms

Financial Reporting Council Audit Quality Review Reports

42. The FRC's Audit Quality Review team (AQR) issued public reports in May 2014 for three and February 2015 for a further one of the seven firms which undertake audits for the Accounts Commission and the Auditor General:
- PricewaterhouseCoopers
 - Deloitte
 - KPMG
 - Grant Thornton.
43. The reports cover the firm-wide systems, policies and processes for ensuring audit quality, and a sample of their audits of public interest entities. In its inspections, the AQR team monitors firms' compliance with Auditing Standards, Ethical Standards and Quality Control Standards. The FRC has also produced an annual report summarising all of its inspection work. This brings together common findings and examples of good practice.
44. The four firms' public reports show a better combined performance when compared to the sample of firms overall inspected by the AQR team, with 70% of the audits sampled being assessed as *good with limited improvements required* (58% for the whole population), 20% as *acceptable overall with improvements required* (25%), and 10% *requiring significant improvement* (17%). The results are broadly consistent with the previous year.

The Institute of Chartered Accountants of Scotland Audit Monitoring

45. The three appointed firms outwith the AQR inspection scope (Scott-Moncrieff, Wylie & Bisset and Henderson Loggie) are registered by ICAS to carry out audit work and fall within its audit monitoring responsibilities. ICAS's Annual Audit Monitoring Report for 2014 provides indirect assurance about compliance by these firms with auditing standards.

Firms' own quality control results

46. Firms carried out six quality control inspections relating to public sector audits procured for the Auditor General or Accounts Commission. All six reports concluded that the audits inspected complied with ISAs in all material respects but identified areas for improvements.
47. Annual transparency reports published by the five largest firms which provide external audit work for the Auditor General and the Accounts Commission were obtained and reviewed to

ensure the information within them was consistent with Audit Strategy's understanding of quality arrangements within these firms. The FRC's AQR team also read the firms' transparency reports during their audit inspections. The transparency reports and the FRC's findings do not report any areas for concern.

Appointed auditors

48. Audit Strategy reviews reports of regulatory bodies about the quality of audits performed by appointed firms. Most firms use consistent methodologies across all their audit work and therefore the results of their reviews provide useful information about the quality of the firms' work on public sector audits.

Review of audit outputs

49. A sample of 62 2013/14 annual audit reports (60 in 2012/13) was reviewed by Audit Strategy for their compliance with the Code of Audit Practice, and as an assessment of the quality of reporting to the audited bodies. The review covered all sectors and all audit providers.
50. The key findings from the product read exercise were that reports complied with the Code on the whole and were of a good quality. Examples of good practice and areas for improvement, including a checklist to help with compliance, were reported back to auditors in March 2015.

Audit service quality surveys

51. Audit service quality surveys were issued to 23 health boards and 20 further education colleges asking for feedback on the 2013/14 audits. Response rates were 65% and 70% respectively.
52. The key indicators are:
 - what audited bodies thought of the quality of service provided by the auditors
 - whether the audit had made an impact on the bodies in the four areas defined in Audit Scotland's corporate impact framework
 - whether relevant national performance reports had had an impact on the body.
53. A summary of the responses received is shown in [Exhibit 6](#). The feedback was significantly positive in terms of the quality of audit service delivered and the overall impact of audit work. The impact of national performance reports is reported in more detail at paragraph 68 to 71.

Exhibit 6: High level results of audit service quality surveys

	Health boards % positive responses	Further education % positive responses
Overall quality of service	87	100
Overall audit impact	73 (Finance Directors) 75 (Audit Committee Chairs)	100 (Finance Directors) 93 (Audit Committee Chairs)
Impact of audit on:		
• Financial sustainability	47	77
• Transparent reporting of financial & other performance	64	85
• Value for money	43	67
• Governance & financial management	79	92

Source: Audit Strategy

54. A number of colleges commented on the helpfulness demonstrated by their auditor as they managed the reclassification of the further education sector by the Office for National Statistics and the impact of this reclassification on accounting periods.

Thematic work

55. Audit Strategy carried out a review of materiality in 2014 following up on the FRC's thematic review of the same topic. The review applied the principles of the FRC review to audits carried out under appointment, leading to recommendations to improve consistency of maximum materiality levels, and improve disclosure of materiality, planning materiality and levels of errors to be disclosed to audited bodies.
56. Audit Strategy conducted a review of auditors' opinions in 2015 to ensure compliance with the model auditor's reports provided by Audit Scotland and ensure that terminology was suitably tailored to the audited body's financial statements. The findings were discussed with auditors to ensure that future opinions followed the model auditors' reports by clarifying the expectation of auditors to comply with the model opinions, and more clearly signposting where local variations should be reflected.

Output monitoring

57. **Exhibit 7** sets out the key outputs from the audits of the 2013/14 financial statements.

Exhibit 7: key outputs by sector

	Local government	Health	Central government	Further education
Audit opinion on time	30 Sept 14 76/76 (100%)	30 June 14 22/23 (96%)	31 Oct 14 72/74 (97%)	10 Oct 14/ 31 Dec 14 20/22 (91%)
Annual audit report on time	31 Oct 14 66/76 (87%)	31 July 14 21/23 (91%)	30 Nov 14 64/74 (86%)	10 Oct 14/ 31 Dec 14 20/22 (91%)
Accounts sent for laying on time	N/A	31 Dec 14 23/23 (100%)	31 Dec 14 74/74 (100%)	31 Dec 14/ 30 April 15 21/22 (95%)

Source: Audit Strategy

Oversight of acceptance of non-audit work

58. Audit Strategy approved a small number of requests for non-audit work during 2014/15, having assessed them against current Ethical Standards and obtaining assurance that the independence of the external auditors would not be compromised. All such requests were accompanied by express assurance that the firm's designated Ethics Partner had reviewed the proposed work and did not consider it to pose any threats to the auditor's independence.

Respond proportionately to complaints about auditors and audit work

59. Audit Scotland operates a complaints handling process which conforms to the complaint handling procedures set out by the Scottish Public Services Ombudsman. Complaints are systematically analysed, investigated and reported to Management Team and the Board. There have been no complaints by audited bodies about the quality of work undertaken by auditors this year. This is an important element of the overall assurance on the quality of auditors' work.

Consideration of conflicting audit judgements between auditors

60. There have been no conflicting judgements between auditors this year leading to different audit opinions being given. Guidance on key technical matters to inform auditors' judgement has been provided by the Technical Services Unit (TSU). In addition, in the course of the year, there have been regular sectoral meetings and technical forums involving auditors from each of the four sectors where emerging or contentious technical issues were discussed.

Performance Audit and Best Value

61. PABV's quality management processes are fully documented in the PABV Audit Management Framework, which is used for all performance audits, Best Value audits, *How councils work* reports, overview reports, Community Planning Partnership audits and statutory reports based on annual audit reports. **Exhibit 8** provides an overview of these arrangements. The arrangements are expanded upon in the **Appendix**.

Exhibit 8: Overview of PABV's quality management arrangements



Source: *Performance Audit and Best Value*

Assistant director review

62. Assistant directors carried out reviews on the audit work for the 29 reports published in 2014/15. The reviews confirmed that the work had been carried out in accordance with the PABV Audit Management Framework and quality arrangements and met their audit objectives.

Peer review

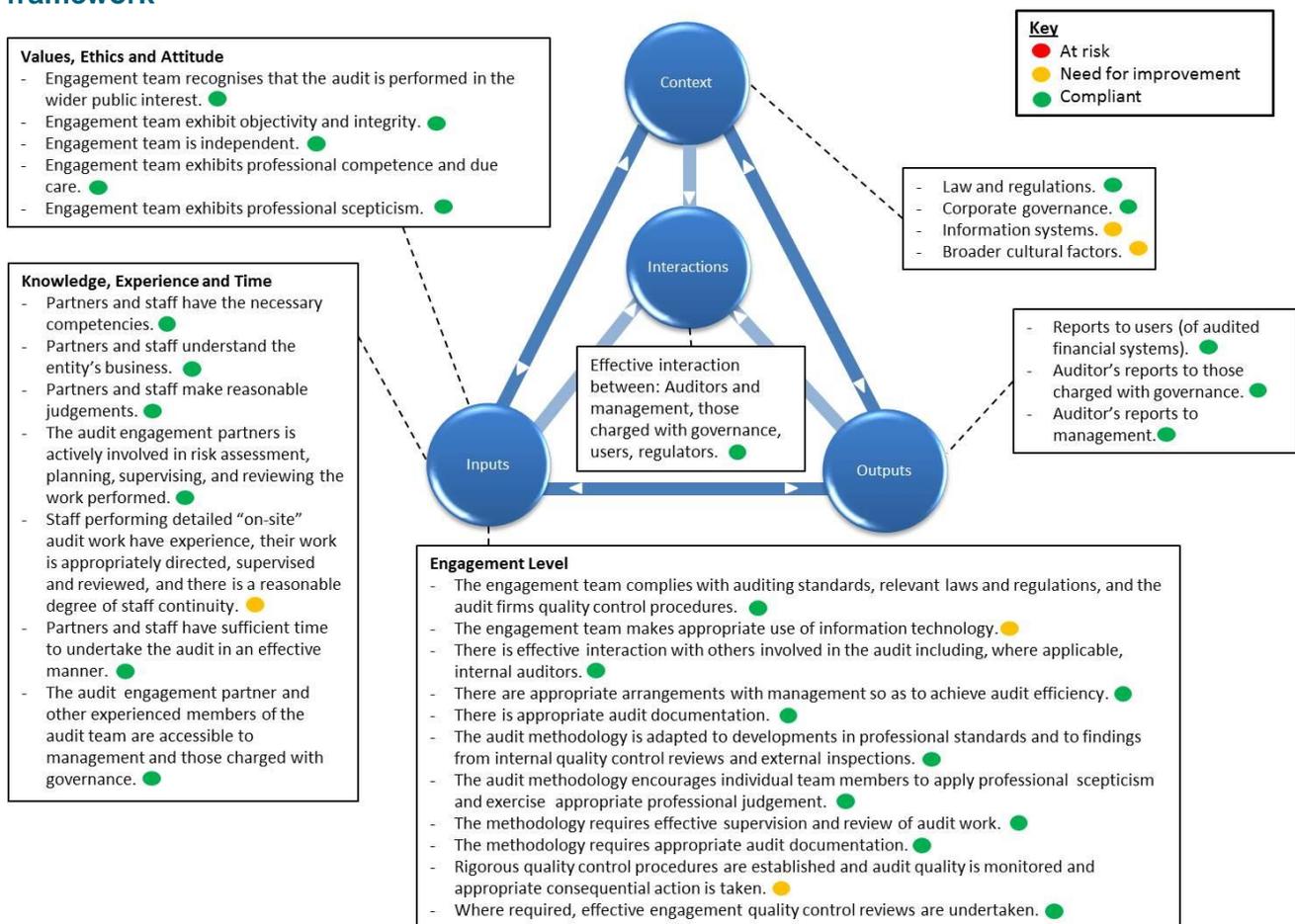
63. PABV continues to participate in peer review of performance audit reports with the UK partner audit agencies (NAO, NIAO, and WAO). The main Audit Scotland report that was subject to

peer review during 2014/15 was *Procurement in councils*. The findings were positive, with particular emphasis on the clarity of audit judgements, good use of data and case studies, and the strength of the evidence base to support audit recommendations. A small number of relatively minor areas for potential improvement were identified. These included the need for greater precision in the use of the term 'significant' (ie, whether or not the term means statistically significant) and the need to address a technical accessibility problem when performance audit reports are converted from PDF to text format. PABV staff also provided peer review feedback on the WAO audit reports on *The Management of Chronic Conditions in Wales*, and *Young people not in education, employment or training* (July 2014).

Benchmarking against the IAASB framework for audit quality

- 64. During 2014/15, the quality and impact group reviewed PABV's arrangements for managing audit quality against the IAASB *A Framework for Audit Quality*. The key findings from that review work are set out in **Exhibit 9**.

Exhibit 9: PABV's quality management arrangements assessed against the IAASB quality framework



Source: *Performance Audit and Best Value*

65. The key issue arising from this review work was that while overall PABV's approach to managing audit quality is comprehensive, it could be improved further by:
- improving PABV's approach to risk-assessing audits and deploying staff appropriately, to better demonstrate compliance with the risk assessment, skills and competence and staff continuity requirements of the IAASB framework
 - establishing a system for quality monitoring 'cold' reviews of a sample of PABV audits to independently assess compliance with PABV's audit management framework to better demonstrate compliance with the audit quality control procedures requirements of the IAASB framework
 - providing consistent induction training on audit quality for all staff in PABV so that Audit Scotland's values, ethics and attitudes to quality, and PABV's audit quality management arrangements are effectively communicated to all staff before they start any audit work
 - ensuring that all staff in PABV receive appropriate and well tailored ongoing training and support in relation to: managing audit evidence; demonstrating professional scepticism; and making and reporting clear audit judgements
 - improving the visibility of quality management and more effectively communicating the outcomes of quality review work within PABV to raise the profile of quality and set the right 'tone from the top'
 - ensuring that interaction with management and those charged with governance in audited bodies and service users improves based on developing the policy portfolio cluster work
 - ensuring that the new approach to World Class programme development considers the specific requirements that apply to public sector audits
 - making more effective use of ICT as part of audit work.

Impact assessment and reporting

66. PABV published three impact reports during 2014/15:
- *Early departures* (original audit report published May 2013)
 - *Reducing reoffending in Scotland* (original audit report published May 2014)
 - *Health inequalities in Scotland* (original audit report published June 2014).
67. Key themes that emerged from impact reporting were the importance of ensuring that findings and recommendations are effectively communicated to the people with the authority and ability to lead and implement change and improvement, that interest in all of Audit Scotland's work spreads well beyond the primary audience of the Public Audit Committee (eg consideration of the Health inequalities report at the Health and Sport Committee), and the regular citing of Audit Scotland reports in parliamentary questions and ministerial responses.

Audit service quality survey results

68. Audit service quality surveys that were issued to NHS and further education bodies following the 2013/14 audits included questions on the value and impact of performance audit reports. The responses are summarised in **Exhibit 10**.

Exhibit 10: Audit service quality survey results NHS and further education bodies

Did the report help you manage and improve your services by:	NHS Financial Performance 2013/14 (%)	Accident & Emergency (%)	Reshaping care for older people (%)	Scotland's colleges 2013 (%)
better understanding of financial sustainability	67	56	88	83
more transparent reporting of financial and other performance	75	60	86	85
our body providing better value for money	45	70	43	73
improved governance and financial management	92	70	67	85

Source: Audit Strategy Group

69. The service quality surveys also include free text comments from respondents. A sample of representative quotes is set out in **Exhibit 11**.

Exhibit 11: Selection of quotes about performance audit reports

Scotland's colleges 2013



“... provided useful information for benchmarking and value for money purposes”



“informed us with regard to the sector's financial sustainability”

NHS Financial Performance 2013/14



The benchmarking... “was useful in terms of transparent reporting and governance issues”



The report was “used... in our ongoing review of resources and patient flows”

Accident and Emergency



“We are a national health board and are not patient facing. This report will not have a direct impact on our organisation”



“The report informed our clinical strategy work around health & social care integration”

Reshaping care for older people



“This was an excellent piece of work that generated a number of questions within our local context to help us understand better our local variation and how this impacted on outcomes and resource/service utilisation”



“It gave us better context within which to evaluate recent local redesign”

Source: Audit Strategy Group

- 70.** Overall the results of the 2013/14 surveys suggest that satisfaction with performance audit reports is high. However, a number of bodies, particularly special health boards expressed a view that performance audits often do not help them and therefore the fee mechanism in which a proportion of their fee paid for such audits was unfair.

71. The key issue from this feedback is the need to improve support to local auditors in communicating the messages arising from national reports. This will feature in programme development work.

Accounts Commission sponsor and Auditor General reviews

72. Where the Accounts Commission are report sponsors and reports are published by the Auditor General, assurance is obtained directly by the report sponsors and the Auditor General as part of their arrangements to review planned work and final drafts of the reports. Learning points from these reviews have been fed into the lessons learned reviews.
73. In addition, members of the Accounts Commission met with representatives of seven audited bodies following the publication of audit reports during 2014/15. The meetings focussed on key audit findings, the audited bodies' response to those issues and feedback from the audited bodies on the audit process itself. Feedback from the audited bodies has been positive and constructive.

Controller of Audit quality feedback from audited bodies

74. The Controller of Audit (Fraser McKinlay) met with 11 local authority chief executives during 2014/15 to hear about their issues and priorities and to gather feedback on their experience of local external audit. Those discussions offered useful quality feedback on PABV's Best Value audit work, performance audits, the Accounts Commission's *How Councils Work* series of publications and the effectiveness of the shared risk assessment process, all of which have been fed in to PABV's quality and impact group for consideration and, where appropriate, action.
75. The key quality issues arising from those meetings were:
- Overall very positive feedback was given on the quality of external audit support received by councils and on the work of Audit Scotland and the Accounts Commission nationally.
 - Strong support was expressed for the Accounts Commission's *How Councils Work* series of reports that highlight good practice and offer opportunities for self-evaluation by councils.
 - The broader impact that individual Best Value audit reports have on the wider local government community was a common theme.
 - There is strong support within the local government community for the SRA process, but the need to better join up some aspects of national scrutiny was identified by several chief executives.
 - Opportunities were identified for more engagement with councils on the local implications of the findings of national performance audit reports.

Quality feedback from the Scottish Parliament's Public Audit Committee

76. The feedback received from the Public Audit Committee on the quality of Audit Scotland work has been consistently positive, as is shown by the following recent quotes from committee members:

- *“Their work is exceptional. It is of the highest professional quality, and it is incisive and concise, which is always helpful. To be frank, we could not do our work without that input from Audit Scotland.”* Hugh Henry, Wednesday 14 December 2014, Public Audit Committee.
- *“One assumes that Audit Scotland is just about numbers, but I am impressed by your knowledge of cables and various other things, too. You have done very well in answering our questions.”* Sandra White, 11 March 2015, Public Audit Committee (Discussing the Broadband report).
- *“I thank Audit Scotland for pushing this agenda really hard, because it is very important”* Tavish Scott, 1 April 2015, Public Audit Committee, (Discussing Borrowing and Treasury Management).

77. Even when feedback is positive there remains scope to improve. An important element of PABV's World Class programme development will be refining and improving arrangements for engagement with the PAC and other parliamentary committees that have an interest in Audit Scotland's work.

Developments in audit quality arrangements

Audit Services: Developments

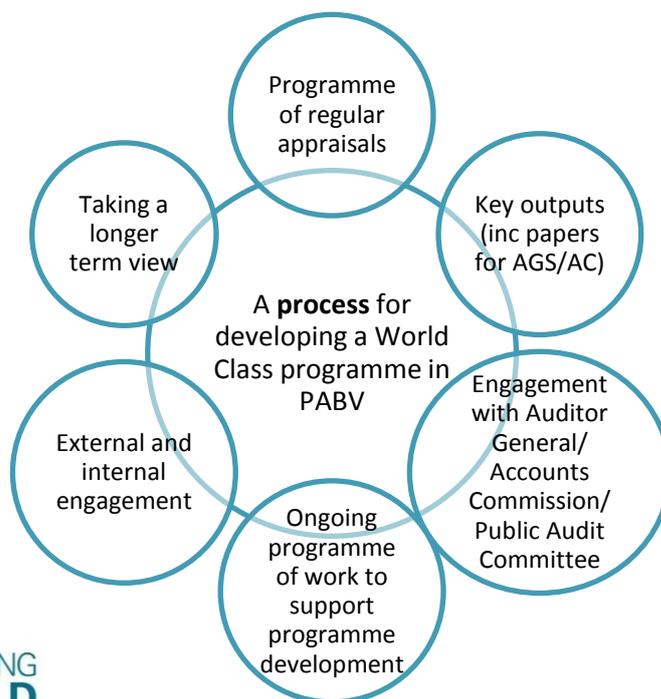
78. ASG has a well-established framework for delivering audits which complies with relevant auditing standards. In 2014 ASG continued to streamline the audit approach in order to reinforce the importance of focussing on judgements, professional scepticism and de-clutter audits.
79. ASG's electronic working papers package, MKI, is now well-established across all teams in ASG. Its usage, along with the audit guide (updated in June 2014) ensures consistency of working practices across ASG. MKI also helps to ensure transparency of work and access enabling members of the Business Improvement Unit to interrogate all of the work undertaken by ASG.
80. ASG teams introduced combined ISA260/Annual Audit Reports Across a significant number of central government audits, with earlier conclusion of the audit as a consequence. This was universally welcomed by the audited bodies affected and will be extend to all 2014/15 audits. ASG also introduced clearer reporting of audit risks, related audit activity and judgements in all Annual Audit Reports.
81. ASG combined the Quality Team and the Professional Standards Group into one Professional Standards and Quality Improvement Group (PSQI) toward the end of 2014. The objective of the change is to provide a much clearer 'feedback loop' between quality review processes and the audit approach. This will help 'engineer-out' quality issues through improvements in the underlying approach. PSQI will develop an aspect of quality review focused on thematic issues based on interrogation, and the quality responses will be far-wider than reporting and individual action plans. This wider approach is expected to include targeted training at an individual or team level and ASG-wide training.

Audit Strategy: Developments

82. Audit Strategy has developed a quality scorecard which gathers together the various strands of quality monitoring activities for each of the audit providers. The scorecard provides a clear overview of the work of audit providers and enhances feedback discussions with auditors to support quality assurance.
83. Audit Strategy began carrying out thematic work to support improved audit quality and consistency. The use of thematic work will be further developed, working in conjunction with ASG's PSQI to help identify risk areas and avoid duplication of effort.

Performance Audit and Best Value: Developments

84. A PABV quality and impact group was established in 2014 to streamline quality processes in a single *Quality Framework*. The terms of reference of the group are to: “oversee our management of audit quality and ensure that we maximise the impact of our work.” The main focus of the quality and impact group during 2014/15 has been on:
 - implementing a single framework for managing quality consistently across PABV
 - benchmarking PABV's approach to managing quality against the IAASB's *Framework for Audit Quality*
 - considering corporate impact group proposals to enhance the promotion and generate greater impact from PABV national reports
 - refreshing PABV's approach to impact reporting to Management Team and the Accounts Commission's Performance Audit Committee.
85. Responsibility for overseeing audit quality management within PABV will be separated from PABV's approach to supporting the corporate '*making a difference*' agenda which is part of Audit Scotland's broader becoming World Class audit ambitions. Creating two distinct groups will allow work to spread more widely across the group, creating greater capacity for change. Some cross-membership of the two groups will be encouraged so that synergies between these two linked agendas are identified and the benefits of these are maximised.
86. These changes will give PABV the capacity and impetus to make the strategic shifts needed to deliver World Class quality management and make a difference during 2015/16.
87. During 2014/15, PABV began a project to improve its approach to programme development. Securing greater impact from audit work lies at the heart of this new approach to improving programme development. The key strands of the improvement agenda underpinning this programme of work are set out in **Exhibit 12**.

Exhibit 12: Implementing World Class programme development in PABV


Source: Performance Audit and Best Value

88. Audit Scotland is a member of the UK audit agencies peer review forum. All the agencies have agreed that there is a need to refocus the joint QA work to ensure that it is generating greater learning and added value for everybody concerned.

Conclusion

89. Overall, the arrangements in place and activity for the year provide assurance that Audit Scotland and the appointed firms continue to provide the Auditor General and the Accounts Commission with quality work.
90. In particular, the quality appraisal work carried out by Audit Strategy on the work of the firms and ASG has confirmed that each auditor:
 - understands and complies with the Ethical Standards in force during the course of the audit and is independent of the audited body
 - has the required professional competence to carry out the audit in accordance with relevant standards and the Code of Audit Practice
 - operates in a regulatory environment that actively oversees auditors
 - has delivered audit opinions that can be relied upon
 - delivered timeous reports which have met the needs of a majority of key stakeholders.
91. The audits undertaken by ASG and the firms would therefore satisfy IAASB's definition of a quality audit (as per paragraph 22 above).
92. The report demonstrates that arrangements across Audit Scotland's business groups are continuing to develop, with the aim being to ensure that the quality monitoring framework remains effective.

Appendix: Quality arrangements

This appendix summarises the quality arrangements in place across the organisation.

Audit Services: Quality arrangements

ASG's framework covers financial audit, ethical and quality standards as required by the FRC. The foundation of ASG's quality framework is the ASG audit guide, which incorporates the application of professional auditing, quality and ethical standards together with the Code of Audit Practice, into an audit methodology which is used across all audits in ASG. The audit guide is supported by a number of guidance notes on specific issues such as audit testing guidance.

The PSQI, which consists of staff members from across ASG and reports directly to ASG's management team, oversees the development of the audit guide and the integration of any new standards into ASG's audit approach. The audit guide is kept under review and was most recently updated in June 2014.

In addition to complying with the audit guide, auditors are required to complete audit engagements using a software tool called MK Insight (MKI), an electronic working paper package which allows them to document their work to provide evidence of compliance with relevant auditing standards. The package also incorporates appropriate levels of supervision and management.

ASG carries out Peer Reviews in accordance with ISQC1 requirements to perform engagement quality control review for all audits meeting certain criteria. The criteria for selection includes the level of fee income (size), assessed risk and where any modification to the audit opinion is expected

Peer reviews are undertaken by Assistant Directors/ Director within ASG before audit reports (certificates) are issued and concentrate on identified audit risks, audit responses, and adequacy of evidence and judgements. Any significant issues are resolved by the certifying auditor before an auditor's report is issued. Peer reviewers have no involvement with the audit in the current or recent financial years, in line with ASG's rotation policy.

ASG operates a rotation policy which complies with the Ethical Standards. The policy is designed to reinforce auditor independence by rotating key senior staff every five years and thus protect against threats to independence such as over-familiarity with management at an audited body. ASG staff must complete an annual fit and proper declaration which covers time spent on particular audits as well as compliance with Audit Scotland's Code of Conduct.

Quality reviews are undertaken by a subgroup of experienced senior staff from PSQI. Each year the team undertakes 'hot' and 'cold' reviews of audits. Hot reviews are carried out during the live audit process, focusing on judgements and risks, primarily at the planning stage of the

audit and ensuring that audits are carried out in accordance with ASG's audit guide. Cold reviews are undertaken after the issue of the audit report and cover the same issues, but with additional work which looks more broadly at the wider conduct of the audit including the soundness of the audit opinion and the impact on the public body.

ASG has a programme of cold reviews which aims to ensure that all financial audit engagement leads are subject to review over the portfolio appointment period, supplemented by periodic external reviews. The audits selected for coverage are based on a combination of the risk profile of the audit, planned coverage of engagement leads and a mix of sectors.

The managers and teams responsible for individual audits reviewed are provided with reports on the findings of the review and provide responses to the findings in each report, often resulting in actions for improvement for each team.

As part of the review process, PSQI works with other UK audit agencies. The Northern Ireland Audit Office (NIAO) and the Wales Audit Office (WAO) undertake a small proportion of ASG's reviews, with Audit Scotland's staff providing reciprocal reviews of NIAO and WAO audits.

In addition to providing ASG with further external assessment of its work, these reciprocal cold reviews provide the PSQI members with the opportunity to identify differences in approach among the UK audit agencies and to bring back examples of good practices or to challenge existing practices.

PSQI considers the findings from the reviews and identifies where changes to audit methodology, audit programmes and reporting are required. Changes are then implemented across the ASG through revisions to the audit guide, MKI audit programmes, reporting templates and through training events such as streamlining technical sessions and the Annual Audit Update.

The work of PSQI incorporates mandatory annual practitioner updates for all ASG staff. These annual update sessions provide training on changes to the audit guide and developments in auditing and professional standards. In 2013, ASG undertook a more wide ranging review of its audit approach in which it sought to reinforce the importance of focus on judgements and professional scepticism and help de-clutter audits.

ASG management team and PSQI consider and respond to any reviews or reporting of audit approach or quality issued by Audit Strategy.

Appointed Firms: Quality arrangements

At the start of the five year audit cycle in 2011/12, all the appointed audit firms were also required to complete a detailed questionnaire setting out how their quality arrangements complied with ISQC1. As part of this initial process, the firms and ASG submitted details of their internal quality monitoring activity for the audits which they would carry out under their appointment by the Auditor General and the Accounts Commission.

Where firms plan to undertake any non-audit work for the audited bodies to which they have been appointed, they must declare to Audit Strategy that they consider such work permissible

under Ethical Standards. Audit Strategy reviews any such assertions and permits non-audit work only where it agrees that the work is consistent with Ethical Standards. This review enhances the independence and ethical conduct of the audits.

During 2014/15 the firms under appointment from the Auditor General and the Accounts Commission completed the following 2013/14 audits:

No of audit appointments: Firm	Central government	Local government	Health	Further education	Total
KPMG LLP	9	9	-	4	22
PWC LLP	10	7	4	-	21
Scott-Moncrieff	-	2	7	5	14
Grant Thornton UK LLP	6	3	-	3	12
Deloitte LLP	1	5	3	-	9
Henderson Loggie	-	-	-	5	5
Wylie & Bisset LLP	-	-	-	4	4
Total	26	26	14	21	87

Audit Strategy: Quality arrangements

Audit Strategy carries out a quality appraisal function for all financial audits conducted under appointment from the Auditor General and the Accounts Commission by the firms and ASG. This work is described in detail in Audit Strategy's Quality Appraisal Framework which was approved in May 2012.

The principal objectives of the quality appraisal work are to:

- provide assurance to the Auditor General and the Accounts Commission on the quality of audit work undertaken
- promote improvements and good practices in auditing.

Audit Strategy carries out a number of activities in its monitoring role:

- Reviews firms' and ASG's quality arrangements including Transparency reporting by firms.
- Reviews external assurance, in particular reports issued by the FRC's AQR team on professional firms as well as monitoring reports produced by ICAS.

- Reviews and assesses audit outputs, giving feedback to auditors on examples of good practice and areas for improvement.
- Issues audit quality surveys, audited bodies in each sector being asked for their views every two years, and reports findings to auditors and to Management Team.
- Monitors audit outputs for timeliness and completeness.
- Oversees acceptance by firms of non-audit work.
- Responds proportionately to complaints about auditors.
- Considers the impact of conflicting audit judgements between auditors.
- Independently reviews audits.

The results of these activities are reported in the 'Results of Quality Assurance Activity' section in the main body of this report.

The IAASB's *A Framework for Audit Quality* highlights the importance of access to high quality technical support. Auditing requires knowledge of a considerable number of technical areas including financial reporting, auditing standards and legislation. The TSU is a small team of technical specialists who keep financial auditors up to date with developments and provide guidance and assistance on complex areas to inform auditors' judgement and support the exercise of professional scepticism.

None of the measures in place provides absolute assurance for any of the elements of the quality appraisal framework. However, absolute assurance cannot be gained, nor is it an aim of the framework to do so.

PABV: Quality arrangements

Arrangements for managing the quality of performance audits draw on a comprehensive project management framework (PMF) that covers each key stage of a performance audit from project selection, audit design, fieldwork and reporting through to post-audit review and impact assessment. The PMF is supported by the in-house performance audit manual and performance audit standards which comply with INTOSAI standards. A comprehensive library of good practice guidance is also available to staff to support their work.

Performance audits, BV audit work, the SRA process, audits of CPPs, statutory reports (S102 or S22), local government overview reports, reports in the *How Councils Work* series, statutory performance reporting and dealing with correspondence from the public, including MPs and MSPs, are covered by the Quality Assurance Framework.

The quality framework is supported by a range of processes, procedures and guidance, including BV toolkits, which provide guidance and direction for staff carrying out BV audit work. The BV toolkits are also available on the Audit Scotland website to ensure openness and transparency and help support improvement activity within audited bodies.

All audit work includes internal and external peer review and challenge, and makes extensive use of independent external evaluation when major new audit developments are introduced, eg CPP audits. All audit teams carry out a 'lessons learned' review following audit work to

identify potential improvements to the audit process for future work. These are supplemented by 'reviews of project reviews' where common issues identified in post-project reviews are discussed by the Group along with potential systems-wide improvements and/or solutions.

The Auditor General and the Accounts Commission are the key stakeholders for PABV reports. Both are involved at the planning and reporting stages of the work to provide input to help ensure that the audits are of a high quality and will meet their needs.

The Public Audit Committee (PAC) of the Scottish Parliament is a key stakeholder for all of the work that is undertaken on behalf of the Auditor General, and for joint work that is undertaken on behalf of the Auditor General and the Accounts Commission. PABV consults the PAC on performance audit work programmes and works hard to ensure that audit reports provide the committee with the evidence that it needs to exercise its role of scrutinising the expenditure and performance of public bodies that fall within its remit.

Glossary

AQR - Audit Quality Review, part of the FRC's audit monitoring activity, responsible for monitoring the audits of all listed and other major public interest entities.

ASG - Audit Services Group, part of Audit Scotland with responsibility for carrying out audits of public bodies falling within the remit of the Auditor General and the Accounts Commission on a five year appointment cycle.

BV - Best Value is a duty of audited bodies or accountable officers; it is defined in statute for local authorities as continuous improvement in the performance of functions. In securing Best Value local authorities are required to balance issues of quality and cost, have regard to efficiency, effectiveness, economy and the need to meet equal opportunity requirements, and contribute to the achievement of sustainable development. A BV audit is one which examines BV and Community Planning.

CPP - Community Planning Partnerships, a process by which councils and other public bodies work together, with local communities, businesses and voluntary groups, to plan and deliver better services and improve the lives of people who live in Scotland. It was given a statutory basis by the Local Government in Scotland Act 2003. PABV conducts audits on the effectiveness of CPPs.

Ethical Standards - Ethical standards are a set of basic principles and essential procedures together with related guidance in the form of explanatory and other material covering the integrity, objectivity and independence of auditors.

FRC - Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. It monitors and enforces accounting, auditing and ethical standards, oversees the regulatory activities of the professional accountancy bodies and operates independent disciplinary arrangements for public interest cases involving accountants and actuaries.

IAASB - The International Audit and Assurance Standards Board, an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, assurance and other related standards, and by facilitating the convergence of international and national auditing and assurance standards.

ICAS - The Institute of Chartered Accountants of Scotland, the first professional accountancy body, it was established by Royal Charter in 1854. ICAS regulates members and firms.

INTOSAI - The International Organisation of Supreme Audit Institutions, an umbrella organisation for the public sector external audit community.

ISA - International Standards on Auditing, the professional standards for the performance of financial audit of financial information. ISAs are issued by the International Federation of Accountants (IFAC) through IAASB and are approved for use in the UK, with any necessary adaptations, by the FRC and are referred to as ISAs (UK and Ireland).

ISQC1 - International Standard on Quality Control 1, the professional standard for quality control, as with the ISAs, issued by IFAC through IAASB and approved for application in the UK by the FRC.

NAO - National Audit Office, responsible for auditing central government in England to hold government department bodies to account and help public service managers improve performance and service delivery.

NIAO - Northern Ireland Audit Office, responsible for auditing central government and local government in Northern Ireland; it also carries out value for money audits, reporting to the Northern Ireland Assembly.

PABV - Performance Audit and Best Value Group, part of Audit Scotland with responsibility for providing a range of audit services to the Auditor General and the Accounts Commission including a programme of national performance audits, Best Value (BV) audits of local authorities, audits of CPP, the preparation of statutory reports (S102 or S22), sectoral overview reporting and scrutiny improvement activity (including shared risk assessments).

PSQI - Professional Standards & Quality Improvement Group, part of ASG responsible for overseeing the development of the audit guide, the integration of new standards into ASG's audit approach, and carrying out internal hot and cold reviews of ASG audit work.

SCPA - Scottish Commission for Public Audit, a Parliamentary body which is responsible for scrutinising Audit Scotland's budget, annual report and accounts and for appointing an external auditor.

SRA - Shared Risk Assessment, a process involving a joint approach using key information about a body to plan scrutiny activity that is proportionate and based on risk. SRA is undertaken by a joint scrutiny network of senior officers from a range of audit and inspection agencies including Audit Scotland, Education Scotland, The Care Inspectorate, The Scottish Housing Regulator and the appointed auditors, leading to the preparation of an assurance and improvement plan (AIP).

TSU - Technical Services Unit, part of Audit Strategy Group, responsible for providing authoritative guidance and practical assistance to external auditors appointed by the Accounts Commission and Auditor General to support them in carrying out their responsibilities under the Code of Audit Practice. TSU's support enhances auditor judgement in technical matters and thereby improves the quality of the audit delivered.

WAO - Wales Audit Office, responsible for supporting the Auditor General for Wales by Auditing the financial accounts of Welsh public bodies, reporting on how services are being delivered, assessing whether value for money is being achieved and checking how organisations are planning and delivering improvements.

Transparency and quality

Annual report 2014/15

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

www.audit-scotland.gov.uk 

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

or info@audit-scotland.gov.uk 

For the latest news, reports and updates,
follow us on Twitter or subscribe to our
email delivery service:

 [@AuditScotland](https://twitter.com/AuditScotland)

 [Subscribe to updates](#)

 pinterest.com/AuditScotland



Audit Scotland, 110 George Street, Edinburgh EH2 4LH

T: 0131 625 1500 E: info@audit-scotland.gov.uk 

www.audit-scotland.gov.uk 