

# Audit Quality in Audit Scotland

Commitment to quality



Prepared by Audit Scotland  
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# Introduction

## Purpose of report

1. This report explains the arrangements in Audit Scotland for providing assurance on the delivery of high-quality annual audits and performance audits of public bodies in Scotland. It has a particular focus on the role played by Audit Scotland's Innovation and Quality (I&Q) business group.
2. Appendix 1 explains some key auditing terms used in this report.

## High-quality public audits in Scotland

3. An external audit provides independent assurance to third parties regarding a specified subject matter. Independent external audit is an essential feature of the public sector. It supports scrutiny of how public money is raised and spent, and the outcomes achieved.
4. The public audit model in Scotland is different to the audit of private sector entities. Some key differences are as follows:

Aspect	Public audit model
Responsibility for auditor appointments	<p>The Auditor General for Scotland (Auditor General) and the Accounts Commission for Scotland (the Commission) are responsible for appointing auditors to conduct the annual audits of public bodies under their respective remits.</p> <p>This contrasts with the private sector where companies appoint their own auditors.</p>
Auditors	<p>Staff in Audit Scotland's Audit Services business group (ASG) are appointed to carry out around two thirds of the annual audits.</p> <p>The remaining annual audits are carried out by accountancy firms appointed following a rigorous procurement process (the firms).</p> <p>Performance audits are carried out by Audit Scotland's Performance Audit and Best Value business group (PABV).</p>
Role of Audit Scotland	<p>Audit Scotland is a statutory body which provides services to the Auditor General and Commission in respect of appointing auditors and supporting them once they are appointed.</p> <p>The Audit Quality and Appointments (AQA) team within Audit Scotland operate independently to arrange for the appointment of auditors, produce the <a href="#">Code of Audit Practice</a> and provide objective assurance on audit quality.</p> <p>I&amp;Q is a business group established in 2022 to support all auditors in the delivery of high-quality audits.</p>

Aspect	Public audit model
Audit scope	<p>At the core of the annual audit is the financial audit of a public body's annual accounts. This involves appointed auditors examining the reported financial transactions and balances of each body in accordance with the applicable financial reporting framework. The scope of this aspect of the audit is broadly the same as in the private sector.</p> <p>However, the Code of Audit Practice approved by the Auditor General and the Commission requires the scope of annual audits to be wider than the accounts and to include conclusions on aspects of public bodies' arrangements, for example, relating to financial sustainability and governance. In local government, the annual audit also includes the audit of Best Value.</p> <p>Performance audits focus on improving the economy, efficiency and effectiveness of public services. Performance audit work may focus on a particular sector or consider broader cross-cutting arrangements. The Auditor General and the Accounts Commission use feedback from stakeholder engagement and consultation to inform the themes and proposed topics for performance audit work.</p>
Controller of Audit role	<p>Under statute, the Accounts Commission appoints a Controller of Audit to consider the results of the audit of accounts, including the wider-scope responsibilities and Best Value auditing. The Controller of Audit makes reports to the Accounts Commission on matters arising from the accounts and on Best Value and acts independently of the Accounts Commission when reporting to it.</p>

**5.** The following framework provides the foundation for how auditors conduct audit work:

- Audits of the annual accounts are required to be carried out by ASG and the firms in accordance with international standards on auditing in the UK (ISAs (UK)). These are the same ISAs as apply in the private sector.
- Auditors are required to carry out the wider scope work in accordance with the requirements of the Code of Audit Practice and supplementary guidance from Audit Scotland.
- Performance audits are carried out by PABV in accordance with standards issued by the International Organisation of Supreme Audit Institutions (INTOSAI). The adoption of INTOSAI standards by Audit Scotland in 2019/20 was a first among UK public audit agencies.

**6.** High-quality audit relies on auditors using their skills, knowledge and experience, while applying integrity, objectivity, and professional scepticism, to enable them to make appropriate judgments that are supported by evidence.

**7.** Quality is at the core of public audit in Scotland and is the foundation for building consistency and confidence across all audit work. The Auditor General, the Commission and Controller, and Audit Scotland are committed to the consistent delivery of high-quality public audits. High-quality audits provide assurance, add value and can support public bodies to achieve their objectives.

**8.** As commissioners of public audit, the Auditor General and the Commission require all annual audits delivered by appointed auditors, as well as the performance audits carried out on their behalf, to be performed to the highest quality. They, therefore, require Audit Scotland to provide independent assurance on the quality of these audits.

## Definition of audit quality

**9.** Although there is no single definition of the term ‘audit quality’ that has achieved universal recognition, professional bodies have carried out significant work in the last few years to describe what the term means in practice.

**10.** The International Auditing and Assurance Standards Board (IAASB) states that: "Audit quality encompasses the key elements that create an environment which maximises the likelihood that quality audits are performed on a consistent basis".

**11.** The IAASB has also set out the key attributes of a high-quality audit:

### Attributes of high-quality audit

A high-quality audit is likely to have been achieved by an audit team that:

- exhibited appropriate values, ethics and attitudes;
- was sufficiently knowledgeable, skilled and experienced, and had sufficient time allocated to perform the audit work;
- applied rigorous audit processes and quality control procedures that complied with law, regulation and applicable standards;
- provided useful and timely reports; and
- interacted appropriately with relevant stakeholders.

**12.** The Financial Reporting Council (FRC) issues the ISAs (UK) and is responsible for monitoring audit quality in the private sector (see Appendix 2 for more information).

**13.** The FRC also issues influential reports, for example setting out their views on what makes a good audit and thematic reviews on particular aspects of audit. The FRC defines high-quality audits as those that:

- comply with the **spirit and the letter** of professional standards;
- are driven by a robust **risk assessment**;
- are supported by rigorous due **process** and **audit evidence**;

- involve the exercise of **professional judgement** and **professional scepticism**;
- **challenge** management effectively; and
- **report** unambiguously the auditor's conclusions.

**14.** Audit Scotland pays due regard to this material when developing arrangements for providing the Auditor General and the Commission with robust, objective and independent assurance over the quality of audits delivered.

## Levels of assurance on audit quality

**15.** Audit Scotland's arrangements are based on three levels of assurance in respect of audit quality. These levels are summarised in the following table:

Level	Nature of assurance
First	Appropriately trained and supported individuals and audit teams working within approved audit frameworks and following guidance from I&Q.
Second	Organisation-wide internal quality reviews and monitoring in accordance with audit quality standards managed by I&Q.
Third	Quality reviews and monitoring carried out by AQA independently from auditors.

**16.** There are arrangements in place at each level to provide assurance on the quality of the audit delivered. The remaining chapters of this report explain the arrangements that comprise each level in more detail.

# Overview of quality arrangements

## Introduction

**17.** This chapter provides an overview of audit quality arrangements in Audit Scotland. It briefly explains:

- The roles of the business groups and teams within Audit Scotland.
- The Audit Quality Framework.
- The Audit Quality Committee.
- Quality reporting.
- The importance of organisation culture.

## Audit Scotland Business Groups and Teams

**18.** ASG and PABV as audit providers have primary responsibility for achieving audit quality. The delivery of high-quality audits is therefore a fundamental objective for both business groups. Key to the arrangements is the management team in each group designating a director to act as a lead on audit quality. Quality leads liaise with I&Q on quality matters.

**19.** AQA and I&Q play key roles in the arrangements for providing assurance on the quality of audits. The following table briefly summarises their distinct roles and is followed by more information on I&Q

Team	Role
AQA	AQA operates at arm's-length from auditors and: <ul style="list-style-type: none"> <li>• maintains Audit Scotland's Audit Quality Framework;</li> <li>• arranges for external reviews of audit quality; and</li> <li>• reports their independent views on audit quality directly to the Audit Scotland Board, Auditor General and the Commission.</li> </ul>
I&Q	I&Q works collaboratively with ASG and PABV to support them in the delivery of high-quality audits, including conducting internal quality reviews.

**20.** The I&Q business group was established to drive continuous improvement in audit quality by leading organisational transformation and development to ensure that Audit Scotland's audit work is innovative and at the forefront of the audit profession. I&Q seeks to ensure that Audit Scotland:

- deploys world-class, cutting-edge audit methodologies;
- embed a culture of innovation and continuous improvement;
- develops and retains staff, and attracts high calibre new recruits; and
- innovates to make audit delivery as efficient and impactful as possible, taking full advantage of new technologies.

**21.** I&Q comprises the following four complementary functions that work in a collaborative manner to achieve the group's objectives:

- **Quality:** Constructive internal quality monitoring activities, including cold and hot file reviews, with a focus on identifying improvement areas and compliance with relevant standards.
- **Professional Support and Learning:** Technical and professional support, guidance and learning, including the development of guides, templates methodology updates, and training.
- **Digital Audit:** Methodologies and best practice through the effective use of new technologies and approaches, with a focus on audit automation, data analytics, and other digital solutions.
- **Organisational Improvement:** Organisational transformation through the Strategic Improvement Programme, strategic planning, and identifying areas for organisational development and improvement.

**22.** It is fundamental to auditor independence that auditors fulfil their ethical responsibilities. I&Q also supports Audit Scotland's Ethics Partner to establish policies and procedures for:

- addressing threats to compliance with ethical requirements; and
- reporting any conflicts of interest and responding in a timely manner.



## Audit Quality Framework

**23.** The [Audit Quality Framework](#), approved by the Audit Scotland Board, is central to Audit Scotland's arrangements for audit quality. The framework:

- encompasses a single set of shared quality arrangements that apply to all types of audit work and to all audit providers
- sets out the three levels of assurance on audit quality
- explains the structure and processes in place to assure audit quality and provide the necessary evidence that professional standards have been met.

**24.** The framework is currently being refreshed by AQA to apply to the new audit appointments though no significant changes are anticipated.

## Audit Quality Committee

**25.** The Audit Quality Committee oversees the quality review programme and provides a forum for discussion on audit quality matters between I&Q, ASG and PABV. The committee:

- comprises the quality leads and other staff from all business groups;
- oversees implementation and maintenance of the internal systems and processes required to deliver the Audit Quality Framework;
- directs and approves the programme of internal quality reviews and monitoring activity undertaken by I&Q;
- considers the results of the internal and external audit quality reviews and the actions required to address any deficiencies;
- monitors the arrangements for ensuring appropriate levels of professional qualifications, staff training and development across Audit Scotland; and
- makes recommendations for improvement in audit quality to ASG and PABV management teams and Audit Scotland's Executive Team.

## Quality reporting

**26.** There are several ways in which quality activities and updates are reported.

**27.** AQA prepares three audit quality reports per year under the Audit Quality Framework: an interim audit quality report in November; the [quality of public audit in Scotland](#) (QPAS) in June; and a supplementary report, also in June.

**28.** Reports are provided to the Executive Team; the Controller of Audit; Audit Scotland's Audit Committee and Board; Accounts Commission; and the Audit Quality Committee.

**29.** Further to this, the following reporting is undertaken:

- Board and Executive Team: quarterly corporate performance report and Professional Support activity report.
- Audit Quality Committee: quarterly reports on ASG and PABV quality findings and updates on the improvement action plan.
- ASGMT and PABVLT: updates every 2-3 months on quality findings and updates on the improvement action plan.
- All staff: quality bulletins every 2-3 months on areas of relevance and focus; annual updates provided at super-team meetings; and annual reporting of quality review outcomes.
- The annual Transparency Report includes the results of quality reviews.

## Culture

**30.** Aside from specific teams and committees, an appropriate organisational culture is a key driver of high-quality audit. Culture can be thought of as a combination of the values, attitudes and behaviours in an organisation and its relations with stakeholders. Essential behaviours and values that merit prominence in the cultural design of an audit organisation are the fundamental principles of integrity, objectivity, independence and professional scepticism.

**31.** The Executive Team and Leadership Group have a key role in setting the appropriate 'tone at the top', ensuring that quality is at the forefront of all the work that we do.

**32.** A key element of each business group is to transform Audit Scotland by developing a culture for the delivery of high-quality auditing driven by clear governance and leadership, which emphasises the importance of quality and the expected values and behaviours of the audit team. I&Q plays a key role in identifying elements of good practice that can be applied to enhance the Audit Scotland culture, and works with each business group to implement them.

**33.** One element of a culture that supports high quality audits is encouraging staff to perceive quality reviews in a positive light and welcome them as a vehicle for improvement rather than view them as a burden to be avoided. I&Q's aim is to create:

- an environment of trust, whereby staff are encouraged to openly talk about areas for improvement and learn from them
- a diverse and open culture of challenge and continuous improvement, from across the spectrum including external stakeholders.

# Level 1: Training and guidance

Appropriately trained individuals and audit teams working within approved audit frameworks and following guidance from I&Q.

## Introduction

34. The objective of the first level of assurance on audit quality is to ensure that:

- individuals in audit teams are trained to have the necessary technical skills and up-to-date knowledge, as well appropriate soft skills so they have the competence and capabilities to consistently perform high-quality audits;
- audit teams adopt appropriate audit methodologies when planning, executing, and reporting on audits; and
- auditors exercise appropriate professional judgment and professional scepticism.

## Professional Support

35. The activities of the Professional Support function within I&Q in this regard are summarised in the following table:

Activity	Features
Preparation of guidance on the application of auditing and accounting standards to the public sector	<p>The guidance supplements the Code of Audit Practice and is provided to ASG and the firms to:</p> <ul style="list-style-type: none"> <li>• inform their judgement</li> <li>• maximise consistency</li> <li>• support the delivery of high-quality audits.</li> </ul>
Development of appropriate methodologies for annual audits, national performance audits, and other outputs, carried out by ASG and PABV	<p>It is important ASG and PABV deploy world class audit methodologies as this underpins the delivery of high-quality audits on a consistent basis.</p> <p>A consistent audit methodology supports the audit team in applying the principles and meeting the requirements set out in professional standards. However, this must be done in a way that is efficient and does not detract from critical thinking and professional scepticism.</p>

Activity	Features
Provision of a central technical support 'help-desk' for auditors to consult with on difficult or contentious matters	Consultation helps to improve overall audit quality by: <ul style="list-style-type: none"> <li>• improving the application of professional judgement</li> <li>• assisting the appropriate application of audit methodologies and professional standards</li> <li>• facilitating meaningful discussion and challenge which should result in more robust, defensible and better documented audit evidence.</li> </ul>

## Learning and development

**36.** The Learning and Development section within I&Q, working closely with Professional Support, provides a wide range of training on:

- key elements of the required audit methodology;
- technical skills (including the use of appropriate technological resources); and
- important softer skills (such as critical thinking and handling difficult conversations).

**37.** Audit Scotland has significantly invested in professional qualifications and training for staff. Professional trainees are provided with an Institute of Chartered Accountants in Scotland (ICAS) training contract upon starting, coupled with valuable on-the-job training and guidance to develop their skills and experience. All qualified staff at Audit Scotland are required to maintain their Continuing Professional Development and take ownership of their own learning and development pathway.

## Digital audit and organisational improvement

**38.** The Digital Audit function within I&Q, working closely with Professional Support, uses specialist expertise to identify, develop and apply the latest technologies to optimise audit efficiency and audit quality.

**39.** The use of technology is a key element of modern audit methodologies. This increases the efficiency of the audit process and includes audit support tools such as those that electronically analyse source data.

**40.** The Organisational Improvement function creates a wider environment that supports, promotes and cultivates high-quality audits. The aim is to develop a culture where delivering high-quality audit work is valued and rewarded, and which emphasises the importance of 'doing the right thing' in the public interest.

## Audit team review and coaching

**41.** This first level of assurance also encompasses quality procedures that are performed by each audit team as the audits progress. This includes, for example:

- the work of audit staff being reviewed by more senior audit staff within the team as the audit progresses to confirm that objectives are being met and the work is being performed in accordance with required methodologies; and
- the provision of on-the-job coaching by more senior audit staff to reinforce learning from formal training and support staff in the practical application of the methodologies.

# Level 2: Internal quality reviews and monitoring

## Organisation-wide internal quality reviews and monitoring in accordance with audit quality standards

### Introduction

**42.** The second level of assurance on audit quality is concerned with organisation-wide internal quality reviews and monitoring in accordance with audit quality standards. Audit Scotland and the firms are responsible for their own arrangements for internal quality reviews and monitoring.

### Applicable audit quality standards

**43.** Until 2021/22 audits, the applicable audit quality standard was International Standard on Quality Control 1 (ISQC1). This set out an audit practice's responsibilities for its system of quality control for audits

**44.** Two new audit quality standards apply from 2022/23, International Standard on Quality Management (ISQM) 1 and 2, which replace ISQC1.

**45.** ISQM(UK) 1 requires a system of quality management to be implemented. that provides reasonable assurance that:

- the audit practice and its personnel fulfil their responsibilities and conduct audits in accordance with professional standards and applicable legal and regulatory requirements; and
- audit reports are appropriate.

### Types of internal quality reviews

**46.** The Quality function within I&Q carries out Audit Scotland's internal quality reviews and monitoring activities. The different types of review undertaken are summarised in the following table:

Type	Activity
Retrospective quality reviews of completed audits after the audit report has been issued (cold reviews)	ISQM 1 requires audit practices to design and perform monitoring activities to provide a basis for the identification of deficiencies in the system of quality management. Monitoring activities are required to include the inspection of completed audits, i.e. cold reviews.

Type	Activity
	<p>The I&amp;Q Quality team typically complete a cold review programme from January to March each year.</p> <p>Audits subject to cold reviews are graded (see below for information in grades).</p>
Quality reviews of audits in progress (hot reviews)	The quality findings arising from hot reviews are issued before the date of signing the audit report and therefore directly contribute to the quality of the audit.
Thematic and in-flight reviews	These reviews of both in-progress and completed audits assess particular areas of interest or risk, sometimes over a range of multiple audits.

**47.** Findings from quality reviews are reported to auditors to share common areas for improvement and good practice more widely. Findings are shared in a number of ways including:

- quality reports issued directly to audit teams subject to review;
- Quality Bulletins distributed routinely to business groups; and
- feedback sessions at audit team meetings.

**48.** Similar internal reviews are also carried out by each firm.

### Grading system for cold reviews

**49.** The cold reviews use the FRC grading system for all of the audits reviewed:

Grade	Standard	Description
1	Good	<p>No concerns regarding the sufficiency and quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed.</p> <p>Only limited weaknesses in documentation of audit work, and any concerns in other areas are limited in nature (both individually and collectively).</p>
2	Generally acceptable but a small number of improvements required	<p>Only limited concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed; and/or</p> <p>Weaknesses in documentation of audit work are restricted to a small number of areas; and/or</p> <p>Some concerns, assessed as less than significant (individually and collectively) in other areas.</p>

Grade	Standard	Description
3	Some improvement required	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  More widespread weaknesses in documentation of audit work; and/or  Significant concerns in other areas (individually or collectively).
4	Significant improvements required	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  Very significant concerns in other areas (individually or collectively).

**50.** The Audit Quality Framework expects audits to be graded as 1 or 2. The target is for at least 80 per cent of audits to receive that assessment over three years.

### Improvement action plans

**51.** Where an audit is graded as 3 or 4, the auditor is expected to put in place a plan to address the required improvements.

**52.** ISQM 1 requires a root cause analysis to be conducted of identified quality deficiencies. Root cause analysis identifies the reasons underlying quality deficiencies and focusses improvement action plans on their causes rather than the symptoms.

**53.** Improvement action plans are prepared alongside the cycle of cold review reporting each spring. The action plans set out:

- the significant quality improvements identified;
- proposed actions;
- the individuals assigned to each action; and
- a planned timeline to implement each action.

**54.** The Audit Quality Committee oversees and monitors the progress made against improvement action plans by ASG and PABV at quarterly meetings throughout the year.



## Engagement quality reviews

**55.** In addition to the quality arrangements described above, engagement quality reviews form a key part of the system of quality management. The reviews are conducted on or before the date of the report to provide additional audit assurance, and the nature and extent of these reviews are relevant to the engagement or business group.

**56.** An engagement quality review is an objective evaluation of the significant judgments made by the audit team and the conclusions reached thereon. Audit Scotland and the firms are required to establish policies addressing audits that are required to be subject to engagement quality reviews.

**57.** ISQM (UK) 2 deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review. In Audit Scotland, these reviews are completed by experienced, senior staff within ASG and PABV.

## Transparency Reports

**58.** Auditors of Public Interest Entities are required by regulation to prepare a Transparency Report each year setting out certain specified matters, including:

- a description of their governance arrangements;
- information on the system of quality management; and
- the results of their internal quality reviews and monitoring.

**59.** Audit Scotland and each appointed firm therefore produce and publish an annual Transparency Report.

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# Level 3: Independent quality monitoring

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Quality reviews and monitoring carried out independently from auditors

## Introduction

**60.** The third level of assurance on audit quality is concerned with independent quality monitoring. Independent monitoring offers the highest level of assurance to stakeholders.

**61.** These procedures are carried out by AQA or an external party appointed by AQA. The procedures are undertaken independently from audit providers though AQA pay regard to the results of internal reviews and monitoring.

## External reviews

**62.** For the five audit years to 2020/21, AQA commissioned ICAS to carry out external quality reviews. The new external quality reviewer from 2021/22 to 2026/27 audits is the Institute of Chartered Accountants in England and Wales.

**63.** The external reviewer also carries out cold reviews of completed audits and awards them a grade. In order to facilitate comparability with internal monitoring, they also use the FRC scoring system.

**64.** The external reviewer also completes targeted follow-up reviews to determine the progress on actions recommended in previous years.

## Annual audit plans and reports

**65.** AQA review a sample of annual audit plans and annual audit reports to assess how effectively auditors comply with the requirements of the Code of Audit Practice and supplementary guidance.

## Audited bodies' views on audit work

**66.** AQA arranges for an annual independent stakeholder feedback survey. It surveys key individuals in audited bodies to gather feedback on the financial and performance audits.

## Assessment and Reporting

**67.** AQA uses the results of the external reviews, their own independent checks, and each Transparency Report to form an objective assessment of audit quality.

**68.** AQA sets out their findings in reports as set out at paragraph 26.

**69.** QPAS is also made publicly available in June each year.

# Appendix 1: Glossary of terms

Term	Explanation
Audit evidence	<p>The information used by auditors in arriving at their conclusions. Audit evidence supports those conclusions and is cumulative in nature. It is primarily obtained from audit procedures performed during the course of the audit. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.</p> <p>Professional standards require audit evidence to be both sufficient and appropriate:</p> <p>(i) Sufficiency is the measure of the quantity of audit evidence. The quantity needed is affected by the auditor's assessment of the risks and also by the quality of such audit evidence.</p> <p>(ii) Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and reliability in providing support for the conclusions.</p> <p>Whether sufficient appropriate audit evidence has been obtained to enable the auditor to draw reasonable conclusions is a matter of professional judgment.</p>
Code of Audit Practice	<p>The Code defines the independent audit of public bodies in Scotland. All auditors appointed by the Auditor General and the Commission and working on their behalf are required to comply with the Code. It sits at the centre of the arrangements for public audit in Scotland, and covers the audit of annual accounts, which has a wider scope than the private sector, performance auditing and Best Value auditing.</p> <p>The Code also sets out the high-level arrangements for monitoring audit quality.</p> <p>Supplementary guidance is used to help inform auditors' judgements and promote a consistent approach to changing public service priorities and risks.</p>
Financial Reporting Council	<p>The body responsible in the UK for issuing auditing and ethical standard and other guidance to auditors, and for monitoring audit quality in the private sector.</p> <p>The FRC will be replaced by a new regulator, the Audit, Reporting and Governance Authority (ARGA).</p>

Term	Explanation
Integrity	<p>Being trustworthy, straightforward, honest, fair and candid; complying with the spirit as well as the letter of applicable ethical principles, laws and regulations.</p> <p>Behaving so as to maintain the public's trust in the auditing profession.</p> <p>Respecting confidentiality except where disclosure is in the public interest or is required to adhere to legal and professional responsibilities.</p>
Professional judgment	<p>Professional judgment is the application of relevant training, knowledge and experience in making informed decisions about the courses of action that are appropriate in the circumstances.</p> <p>Professional judgment is essential to the proper conduct of an audit. Interpretation of professional standards and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience.</p> <p>Professional judgment needs to be exercised throughout the audit. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor.</p> <p>Consultation on difficult or contentious matters during the course of the audit, both within the audit team and between the audit team and professional support, assists auditors in making informed and reasonable judgments.</p> <p>Judgements need to be appropriately documented. Auditors are required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the professional judgments made in reaching conclusions on significant matters arising during the audit.</p>
Professional scepticism	<p>Professional scepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.</p> <p>Professional scepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from staff in audited bodies.</p>
Public Interest Entity	<p>Public interest entities are defined in the Companies Act 2006 as:</p> <ul style="list-style-type: none"> <li>• an issuer whose transferable securities are admitted to trading on a UK regulated market;</li> <li>• a credit institution</li> <li>• a person who would be an insurance undertaking</li> </ul>

Term	Explanation
Root cause analysis	Root cause analysis is a technique for identifying the underlying key causes behind quality review findings, whether specific to one audit or organisation-wide, so that appropriate and achievable actions can be taken to prevent recurrence of deficiencies or to promote the recurrence of positive outcomes.

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# Appendix 2: Quality arrangements in the private sector

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**1.** The auditing profession in the private sector has been under scrutiny due to high profile corporate failures. Various reviews have taken place which culminated in the UK government publishing its report Restoring Trust in Audit and Corporate in May 2022 setting out its plans for action. Plans include:

- replacing the FRC with a more powerful regulator called the Audit, Reporting and Governance Authority (ARGA)
- extending the definition of PIEs to include large private companies
- measures to improve resilience in the audit market for the largest companies. This includes the introduction of a 'managed shared audit' regime which will give 'challenger' firms the opportunity to audit a meaningful proportion of subsidiary audits conducted for FTSE 350 companies.

**2.** Other challenges in the audit profession include:

- the continuing effect of the pandemic which has had a significant impact on the conduct of audits in the UK and has affected audited entities, the firms as well as the operational activities at the FRC
- increasing evidence that there are recruitment difficulties in the auditing profession due to a shortage of skilled and qualified audit staff. 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 audit.

**3.** Under current arrangements, the FRC monitor the quality of the audit work of auditors of companies meeting the definition of PIEs. Monitoring of all other Companies Act audits is delegated by the FRC to Recognised Supervisory Bodies.

**4.** The frequency of FRC inspections varies with larger firms inspected annually while other firms are generally inspected once every three years.

**5.** FRC activity comprises:

- inspections of a sample of audits and related procedures supporting audit quality at individual firms
- thematic inspections which focus on particular aspects of audit across a sample of audits and firms.

**6.** FRC reviews of individual audits:

- focus on the appropriateness of key audit judgments and the sufficiency and appropriateness of the audit evidence obtained
- consider firm-wide procedures including an assessment of how the culture within firms impacts on audit quality
- monitor compliance with relevant professional standards
- identify areas where improvements are required to safeguard or enhance audit quality.

**7.** The FRC agree an action plan with each firm inspected to achieve the improvements needed and assess periodically the adequacy of the progress made by the firm in addressing the findings.

**8.** The results of recent FRC reviews have highlighted deficiencies relating to lack of professional scepticism by auditors, including failures to sufficiently challenge management's assumptions, as well as evidence of the poor application of professional judgement.



# Audit Quality in Audit Scotland

## Commitment to Quality

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
Phone: 0131 625 1500 Email: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)