

Quality of public audit in Scotland

Annual report 2023/24



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Accessibility

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Audit Quality and Appointments

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

Summary

Operating environment

1. 2022/23 was the first year of a new five-year audit appointments cycle which will end in 2026/27. Auditors were also required to comply for the first time with the new [Code of Audit Practice 2021](#). For 2022/23 audits the target dates for completion returned to pre-pandemic dates for all sectors which meant that there was only 10 months between target dates in the NHS sector and 11 months in the local government sector. This operating environment also coincided with an increased ask of auditors under the 2021 Code and compliance with enhanced requirements under auditing standards.

Overall conclusion

2. The [Audit quality framework](#) (AQF) identifies good practice and areas to improve in audit quality. The framework uses a broad range of tools to assess audit quality including external and internal 'cold' reviews and surveys of audited bodies and auditors. Based on this range of evidence the Audit Quality and Appointments team (AQA) concludes that the quality of audit work is:

- **Consistently good in Performance Audit and Best Value (PABV) audit work based on both the independent and internal quality reviews.** The two PABV audits reviewed by the Institute of Chartered Accountants England and Wales (ICAEW) and the two internal cold reviews this year were all graded as 'limited improvements required'.
- **Consistently good over the last four years in four out of six of the accountancy firms carrying out public sector audit work in Scotland based on the independent ICAEW quality reviews and the internal quality reviews of financial audits.** Forty-three out of the 47 cold reviews carried out on accountancy firm audits in the last four years were graded as 'good' or 'limited improvements required'. Only Mazars¹ (three reviews) and Azets (one review) have been graded as 'improvements required' over this period. No accountancy firm has been graded as 'significant improvement required'.

¹ Mazars became Forvis Mazars on 31 May 2024.

- **Mixed in Audit Scotland’s Audit Services Group (ASG) for 2022/23 financial audit work based on the ICAEW’s independent quality reviews and Audit Scotland’s internal quality reviews.** Eight out of the twelve ASG audits reviewed were graded as ‘good’ or ‘limited improvements required’ and met the expected quality standards. Four were graded as ‘improvements required’ and therefore did not meet the expected quality standards. Two internal ASG reviews were also awarded the highest gradings for their 2022/23 audit work. For the second year running no ASG audits were graded as ‘significant improvement required’.
- **Auditors completed 44 per cent of 2022/23 audits by the target dates, a slight reduction from 49 per cent for 2021/22 audits.** This was achieved despite significant obstacles to delivery such as audit handovers, the quality of draft financial statements and working papers submitted for audit, a shortened timetable for NHS and local government and late prior year audits.
- **We expect an improvement in auditors’ capacity to deliver audits by target dates in future years as auditors are not having to manage a handover and have a full 12 months between target dates.** However, this will take time particularly for audits that were delivered late this year.
- **A significant number of material prior year adjustments have been incorporated in the 2022/23 financial statements.** This may be an indicator of an audit quality issue requiring further investigation. Further analysis will be undertaken by AQA to identify any implications relating to audit quality.
- **Feedback on the annual audit from audited bodies continues to show a high level of satisfaction with 87 per cent of respondents considering the annual audit to be fairly or very useful.** Satisfaction has decreased slightly from the highs of 2019/20 and 2020/21 and is now back to 2018/19 levels. Meanwhile perceptions of the quality and usefulness of performance audit outputs have improved slightly.

3. The independent quality reviews provide a clear indication that high quality standards are consistently being achieved in PABV audit work and that it can also be achieved in financial audit. Further work is required in key areas for Audit Services Group and Mazars to ensure that all the audit work consistently meets the high standards expected by the Auditor General for Scotland and the Accounts Commission.

Areas of good practice identified

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

5. One of ASG's six 2022/23 financial audits reviewed by the ICAEW was awarded the highest grade available. This is the second time ASG has achieved this grading in the last three years and provides strong assurance over the high quality of the audit work undertaken.
6. One of EY's 2022/23 financial audits was reviewed by the ICAEW and was awarded the highest grade available. This is the second time this firm has achieved this result in the last four years and provides strong assurance over the high quality of the audit work being undertaken.
7. Five out of six of the accountancy firms subject to an independent review in the last four years have met the expected quality standard for financial audit.
8. Auditor surveys provide evidence that audit providers are continuing to invest in staff training.
9. Stakeholder feedback shows high levels of satisfaction with external audit services provided, the usefulness of the annual audit report, and indicates that the audit work has had impact.
10. Our assessment of appointed auditor compliance with the FRC's [International Standard on Quality Management \(UK\) 1 \(ISQM1\)](#) found that all the audit firms and Audit Scotland have fully implemented the requirements of ISQM1 by the due date of 15 December 2022. Our conclusions are supported by ICAEW's Quality Assurance Department who reviewed Audit Scotland's, EY and Mazars organisational audit quality processes as part of this year's reviews.
11. Our review of a sample of Annual Audit Reports (AARs) found that the majority of the AARs (85 per cent) demonstrated a high level of compliance with the reporting requirements under the Code and related guidance.

Areas for improvement

12. There has been a slight reduction in financial audit delivery performance with only 44 per cent of 2022/23 annual audits being delivered on time (48 per cent in 2021/22). The target dates for audit completion returned to pre-pandemic dates for all sectors with only 10 months between target dates in the NHS sector and 11 months in the local government sector. This ongoing audit delivery performance is concerning as delayed audit opinions impact on the value of external audit assurance and the ability of public bodies to make decisions based on information that has been subject to independent review.
13. ICAEW reviewed one Mazars 2022/23 audit which was graded as 'improvements required', meaning that Mazars did not meet the expected standard. ICAEW did not find any issues which impacted directly upon the auditors' opinion in the independent auditors' report.

14. ICAEW reviewed six ASG 2022/23 audits of which three were graded as 'improvements required' and these therefore failed to meet the expected quality standard. ICAEW did not find any issues which impacted directly upon the auditors' opinion in the independent auditors' report. The overall results represent a decline upon 2021/22, when four out of the five financial audits reviewed by for ASG met the expected standard.

15. Audit staff continue to report concerns that they do not feel they have sufficient time and resources to deliver high quality audit work. Although results have improved for four of the seven audit providers, a stronger focus and ongoing monitoring is needed to assess the effectiveness of capacity building and efficiency initiatives.

16. Staff surveys show a decline to 2019/20 levels for staff experiencing a strong culture of support to carry out a high-quality audit. AQA will continue to monitor and report on this in the next annual report.

Looking forward

17. AQA is reviewing the effectiveness of the current AQF with stakeholders and developing an updated AQF that meets the needs of the Auditor General for Scotland and the Accounts Commission for the remainder of this audit appointment cycle.

1. Introduction

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

19. This report summarises AQA’s assessment of audit quality conducted on audit work, delivered by Audit Scotland and the six appointed firms, on behalf of the Auditor General for Scotland and the Accounts Commission on the 2022/23 audits. The report provides evidence that auditors have designed and implemented audit quality arrangements to assure the quality of their audit work. The report also highlights areas for further improvement.

Public audit in Scotland

20. The public audit model in Scotland is fundamentally different to the audit of private sector companies. The Auditor General for Scotland and the Accounts Commission set out the principles and themes of public audit in Scotland and how it fits with, and responds to, the public policy environment in Scotland in [Public audit in Scotland 2023–28](#). They also set out the scope for public audit for auditors to follow in the [Code of Audit Practice 2021](#).

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

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

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

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

Audit Scotland and appointed firms

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

25. Each appointed firm has its own arrangements for ensuring audit quality for financial audits. Regulation 537/2014 and the Local Auditors (Transparency) Regulations 2020 require the publication of an annual transparency report by audit firms that carry out either statutory audits of Public Interest Entities (PIEs) or Major Local Audits (MLAs). Appointed auditor transparency reports have been reviewed and show good progress is being made to comply with the FRC's ISQM1.

Transparency reports for appointed firms:

- [Audit Scotland](#)
 - Azets does not audit either Public Interest Entities or Major Local Authorities, so it is not required to produce a transparency report and has not done so voluntarily.
 - [Deloitte](#)
 - [EY](#)
 - [Grant Thornton](#)
 - [KPMG](#)
 - [Mazars](#)
-

2. Inputs

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

Ethics

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

Non-audit services

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

29. Auditors carried out permitted non-audit services to the value of £19k during the 2022/23 audits. This equates to 0.07 per cent of the total fees. This compares to £58k which equated to 0.26 per cent of total fees during 2021/22 audits.

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

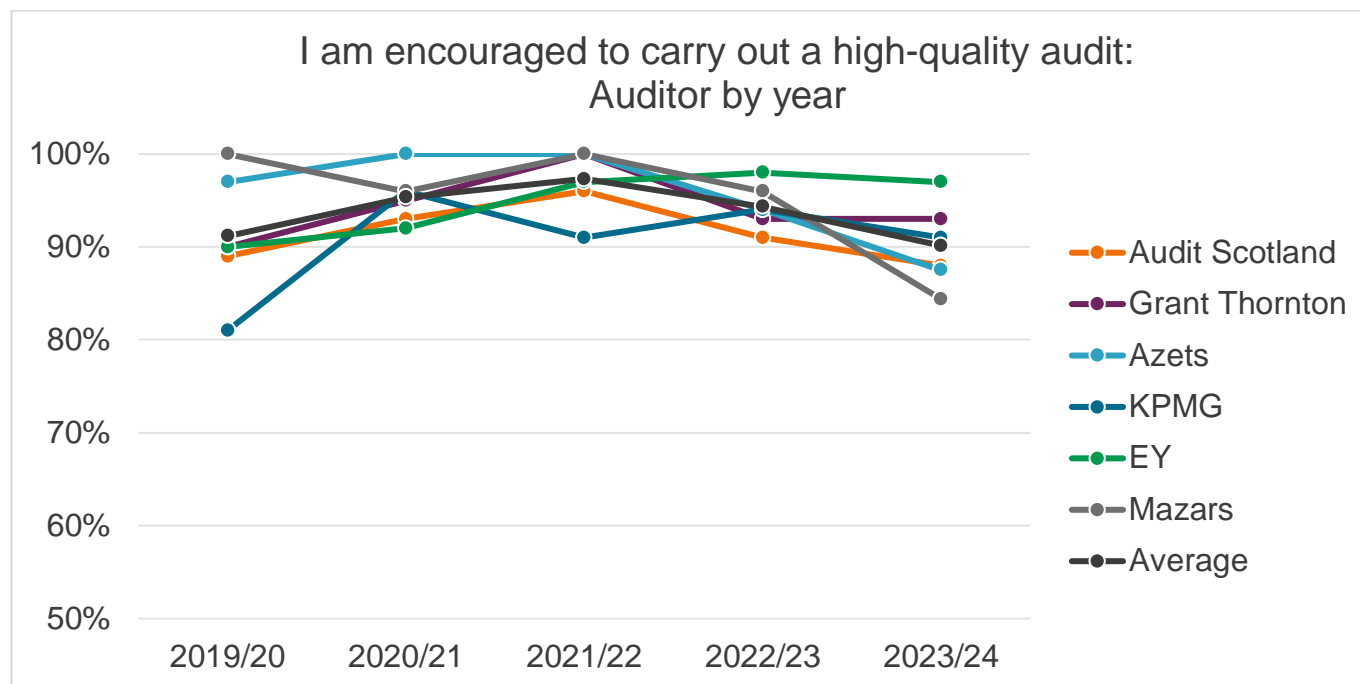
Knowledge, experience and time

31. People are the most important assets in an audit. Having the right staff, allocating the right time to audits and providing the right training and knowledge are critical to delivering high-quality audit work. We are aware from our work in the profession and contact with audit providers that there is a shortage of skills and capacity in the audit profession. Audit providers need to align and monitor their workforce and learning and development plans to ensure they have sufficient capacity to deliver their audit work.

32. Audit Scotland and the appointed firms conduct regular staff surveys to provide an insight into staff views on how well they are supported to provide high-quality audit work. This information enables AQA to monitor

trends over time and allows auditors to take account of the findings in developing their human resources strategies.

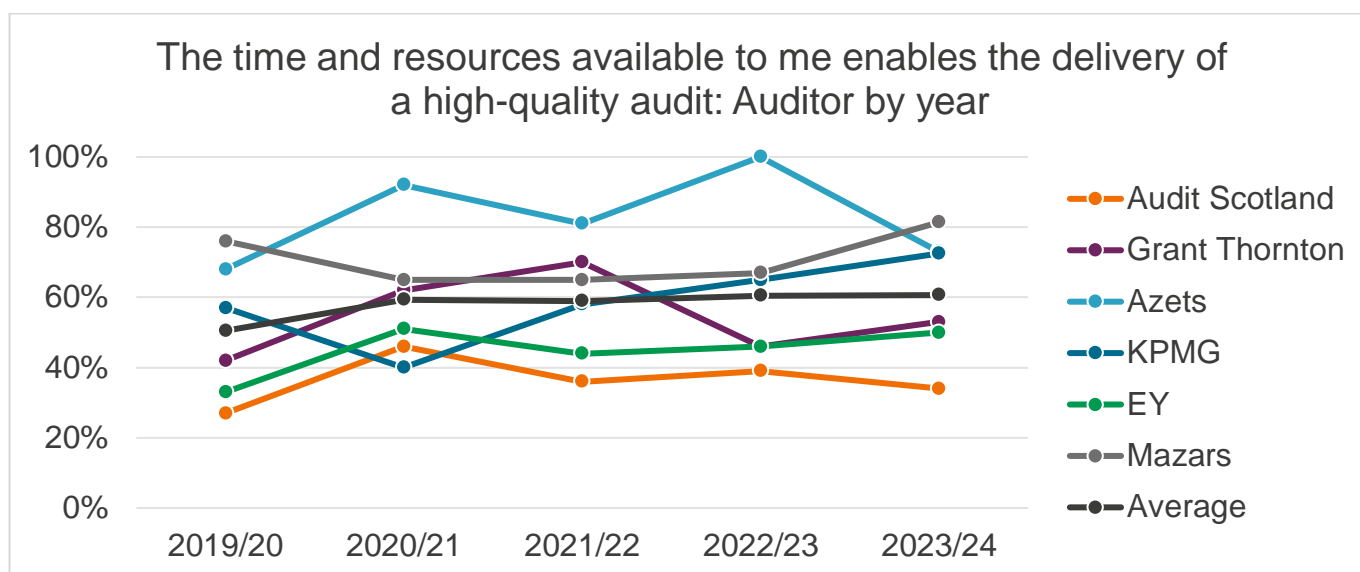
33. The results show that across all auditors, staff experience a strong culture of support to **carry out high-quality audits**. However, the percentage of staff indicating that they are encouraged to carry out a high-quality audit has declined slightly to 2019/20 levels.



Note: Deloitte uses an alternative method of obtaining staff views. A survey was undertaken in 2021 which returned positive results on Deloitte supporting their staff to deliver high-quality audit with some areas for improvement identified. Deloitte conducted its first global survey on their staff's views on their culture of audit quality and will develop actions based on the findings when finalised.

34. Some audit providers returned an improving level of staff satisfaction regarding **the time and resources available to deliver a high-quality audit** compared to the prior year. KPMG and Mazars had the most noticeable improvement compared to 2022/23. Azets had a noticeable decline in results when compared to 2022/23, though are still above the average, highlighting challenges faced during the first year of the new appointment round. In 2023, Azets invested in refreshing their audit methodologies in addition to continuing to provide tailored training to staff. This is an area Azets plans to develop over the coming year.

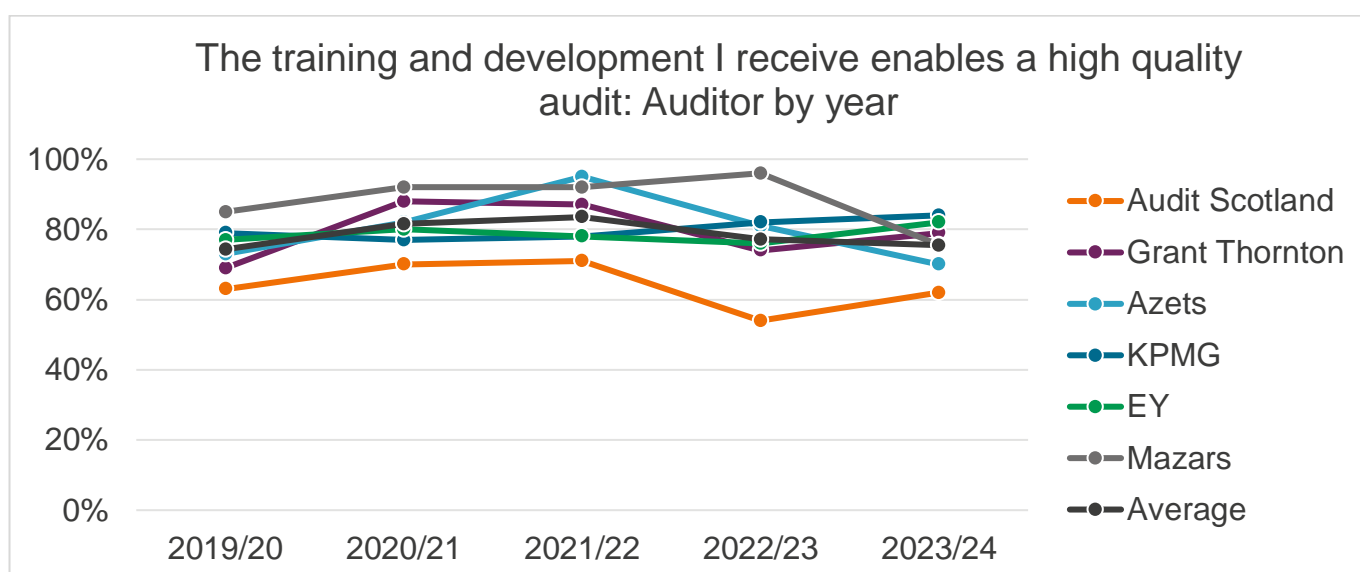
35. The audit quality survey results at Audit Scotland for this area have declined slightly and continue to be at a low position compared to other audit providers.



Recommendation 1.

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

36. The survey results also show that staff continue to be supported to deliver high quality audit work through **training and development** provision by audit providers. Results at Audit Scotland have improved from 54 per cent in 2022/23 to 62 per cent in 2023/24. This improvement follows actions taken from previous internal cold file reviews to provide guidance and training to auditors on aspects of the Audit Scotland Audit Approach alongside a more structured learning and development programme.



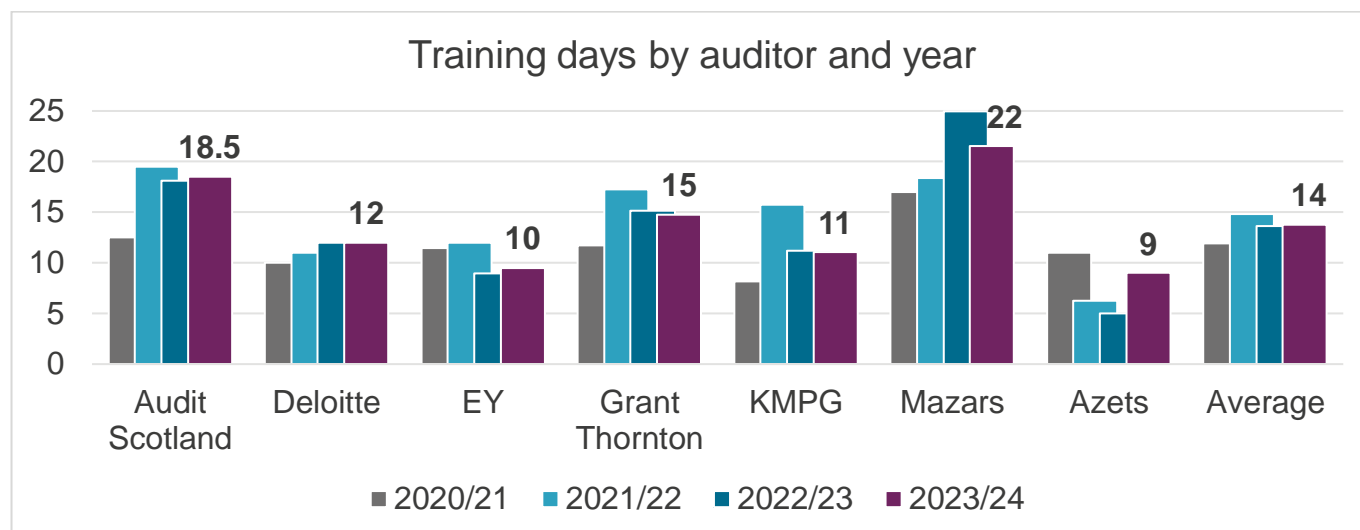
Qualifications

37. Audit work is carried out by appropriately trained and qualified individuals. The firms have 100 per cent (100 per cent in 2021/22) of their staff either qualified or in training. ASG staff were appropriately qualified, with 96 per cent of staff (95 per cent in 2021/22) either CCAB (Consultative Committee of Accountancy Bodies) or Chartered Institute of Management Accountants qualified, or in training for a CCAB qualification. The four per cent of ASG staff not in CCAB training are experienced auditors who are deployed to do appropriate work.

38. Staff in PABV have a wide range of professional and policy backgrounds. These include audit, research, and public policy-related qualifications in disciplines such as economics and social sciences. This depth and breadth of knowledge and insight across the sectors we audit supports the delivery of high-quality work. In addition, 12 PABV staff were also either CCAB qualified or in training for a CCAB qualification during 2023, which could support flexible working across Audit Scotland.

Training

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



40. The amount of time spent on training varies between auditors. This variation arises from the different ways in which training is organised and recorded. Nevertheless, the data shows that considerable investment is being made in training with an overall average of 14 days per member staff (compared with 14 days in 2022/23).

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

3. Outputs

Reporting

Auditors completed 44 per cent of 2022/23 audits by the target dates, a slight reduction from 49 per cent for 2021/22 audits. This was achieved despite significant obstacles to delivery such as audit handovers, a shortened timetable for NHS and local government and late prior year audits. This operating environment also coincided with an increased ask of auditors under the 2021 Code and compliance with enhanced requirements under auditing standards.

Timeliness of financial audit work on the 2022/23 accounts

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

43. Auditors did well to achieve only a slight reduction in the delivery performance compared to the previous year because of the following circumstances:

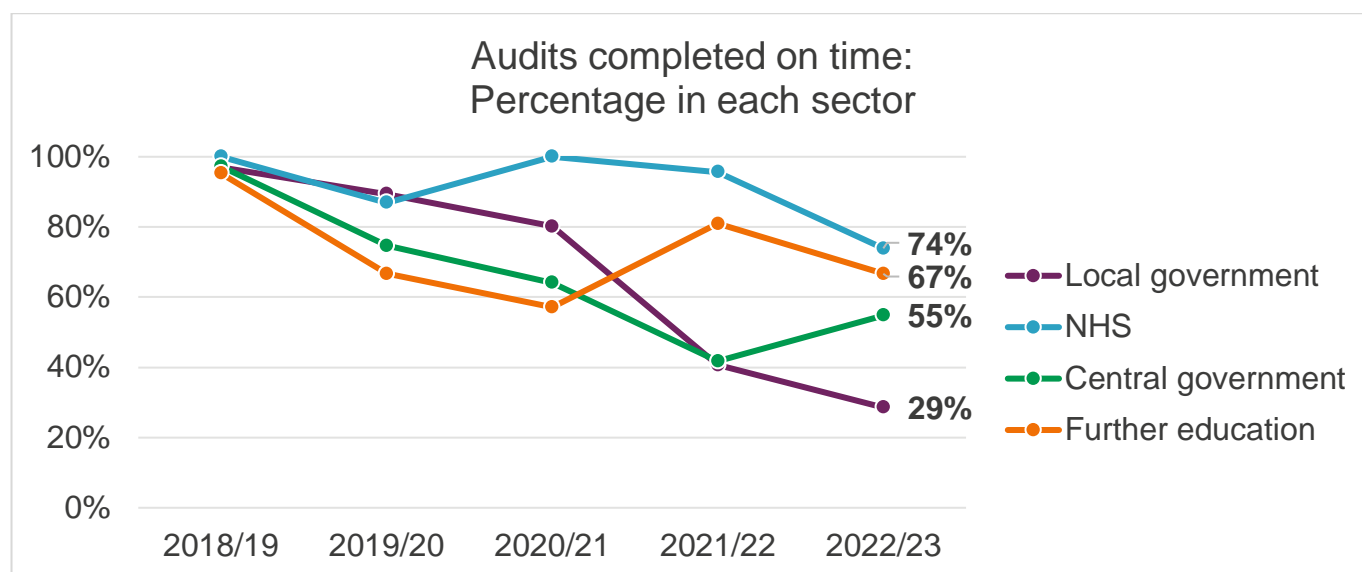
- The 2022/23 audits were the first in the new round of appointments where auditors rotated which increases the work required in the first year.
- Target dates for audit completion returned to pre-pandemic dates for all sectors. This meant that there was ten months between target dates in the NHS sector and 11 months in the local government sector.
- 48 per cent of 2021/22 audits were completed on time, resulting in half of 2022/23 audits being unable to start on time (this year and prior year have been adjusted to include local government charitable trusts for the first time).

44. Auditors also reported that delays were caused by:

- the quality of draft accounts and working papers submitted for audit
- significant adjustments required to accounts
- prioritisation of audits by auditors

- availability of staff, both among auditors and finance staff in audited bodies
- obtaining assurances from auditors at other delayed audits
- scheduling of committees by audited bodies to consider the accounts.

45. Auditors' performance in meeting the targets for 2022/23 audits and the previous four years is shown in the graph below.



46. Delayed audit opinions impact on the value of external audit assurance and the ability of public bodies to make decisions based on information that has been subject to independent review.

47. All auditors are working towards achieving earlier completion of audits. We expect an improvement in auditors' capacity to deliver audits by target dates in future years as auditors are not having to manage a handover and have a full 12 months between target dates. However, it is likely to take a further three years before we return to pre-pandemic delivery performance, particularly for audits that were delivered late this year.

[\(Recommendation 1.\)](#)

Prior period errors

A significant number of material prior year adjustments have been incorporated in the 2022/23 financial statements. This may be an indicator of an audit quality issue requiring further investigation. Further analysis will be undertaken by AQA to identify any implications relating to audit quality.

48. Accounting standards describe prior period errors as omissions from, and misstatements in, the entity's financial statements for one or more

prior periods arising from a failure to use, or misuse of, available reliable information.

49. Auditing Standards require audited bodies to correct material prior period errors retrospectively by restating the comparative amounts for the prior period(s) presented in which the error occurred.

50. The AQF sets a limit of less than 10 per cent of audits to contain material prior period adjustments due to error. Where there is a higher level of prior period errors, AQA should investigate to determine if there is scope for any improvements in audit methodologies. This percentage has increased to 11 per cent (6.7 per cent for 2021/22 audits) which is above the AQF target of 'less than 10 per cent'.

51. We acknowledge that in the first year of the five-year audit appointment it is expected that there will be an increased volume of adjustments due to different judgements and approaches adopted by audit providers. AQA will analyse this further in 2024 to identify the common reasons for prior period adjustments being required at audited bodies and what can be learned for the future.

Modification of audit opinions

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

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

53. The auditor of Glasgow City Council qualified their opinion on the financial statements in respect of City Building (Glasgow) LLP and City Building (Contracts) LLP. The auditor concluded:

- 'At the date of our appointment, the audits for the year ended 31 March 2022 had not been completed for one subsidiary and one joint venture of the Council Group – City Building (Glasgow) LLP and City Building (Contracts) LLP respectively. The audits have now been completed for both entities, but the audits for the year ended 31 March 2023 have not commenced for either entity. We have therefore been unable to issue group instructions to the auditors of these entities, for them to report to us accordingly, or to review any related prior period audit working papers to complete required audit work on opening balances. We were also unable to satisfy ourselves by alternative means using other audit procedures on the entities' consolidated balances, as included in the group

financial statements, for the years ended 31 March 2022 or 31 March 2023. These amounted to net assets of £67 million included in the balance sheet as at 31 March 2023 (2022: £39 million net liability), and £48 million of net income in the CIES for the year ended 31 March 2023 (2022: £14 million net income). Consequently, we were unable to determine whether any adjustment to these amounts was necessary.'

54. The auditor of Social Security Scotland qualified their opinion on regularity. The auditor concluded:

- 'There are estimated overpayments of £60.7 million paid to Scottish residents as a result of fraud and error. This is based on estimates by the Department for Work and Pensions that overpayments as a result of fraud and error in relation to each type of benefit ranges between 1.1 per cent and 5.2 per cent. Overpayment as a result of fraud and error means the expenditure was not incurred in accordance with legislation specifying benefit entitlement. The expenditure is therefore irregular. I consider this level of overpayments to be material to my opinion on regularity. I have therefore qualified my opinion on regularity because the expenditure resulting from such overpayments was not incurred in accordance with the applicable enactments.'

55. The auditor of Ferguson Marine Port Glasgow modified their opinion by providing an emphasis of matter about uncertainty related to going concern. The auditor concluded:

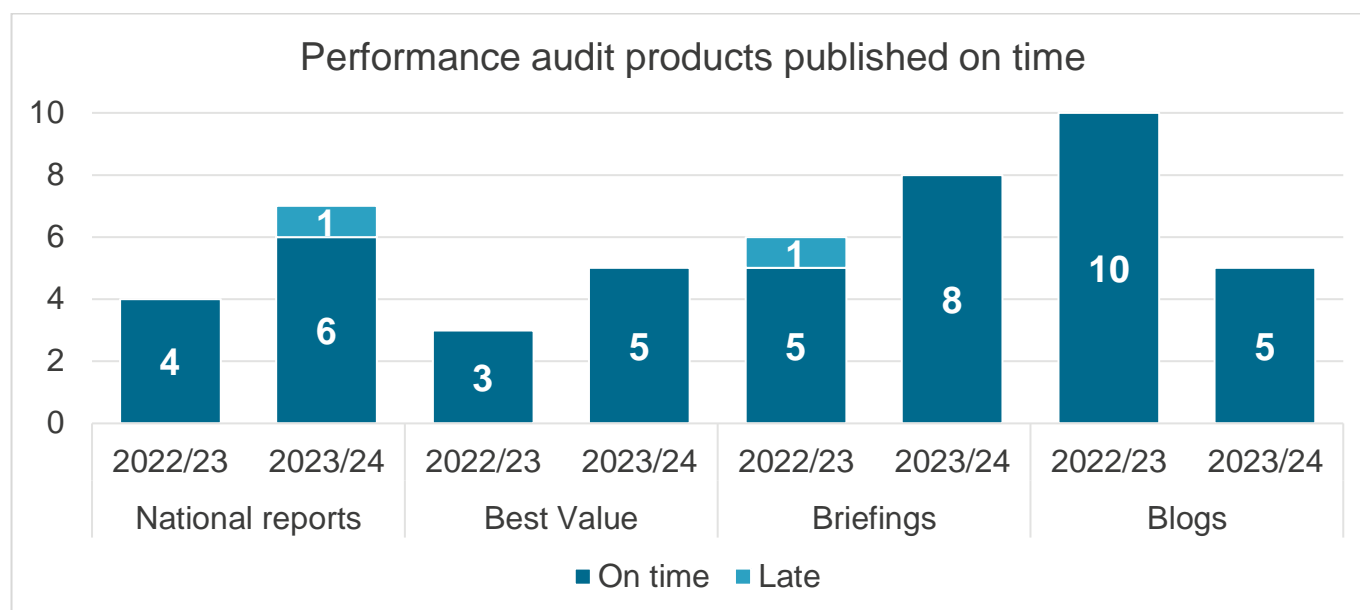
- 'I draw attention to the going concern narrative on pages 4 and 5 in the financial statements, which highlights several risks and uncertainties over the future direction of the business.'

As stated on pages 4 and 5 (Going Concern), these risks and uncertainties, along with other matters as set forth in the Accounting Policies (Note 2), indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern. This material uncertainty is a matter that is important to users' understanding of the financial statements. My opinion is not modified in respect of this matter. I have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate.'

Publication of Performance audit outputs

56. The Auditor General for Scotland and Accounts Commission each have a dynamic work programme that covers a range of public sector bodies and services. The PABV [Work programme](#) is reviewed quarterly to ensure it remains relevant, focussed, and up-to-date and reflects the strategic priorities of the Auditor General and the Accounts Commission.

57. Ninety-six per cent (24 out of 25) of performance audit outputs were published within five weeks of the originally planned publication date during 2023/24 (96 per cent in 2022/23).



58. The performance audit report on Adult Mental Health Services was delayed due to significant absences in the audit team.

59. The Auditor General and Controller of Audit published eight statutory reports in 2023/24, three of which were published after the statutory laying or reporting date. Two were because the audit of the relevant body was completed late and one because of the complexity of the subject coupled with new reporting arrangements.

Quality monitoring





Cold reviews

60. This section summarises the results of independent and internal cold reviews, using the FRC grading system for all audit work. ICAEW replaced ICAS as the external reviewer for 2021/22 audits and carried out the independent cold reviews.

61. ICAEW has extensive experience of conducting audit quality reviews for public sector audit providers including Audit Wales, Northern Ireland Audit Office, and Public Sector Audit Appointments body in England. ICAEW's wide experience further increases the usefulness of the external audit quality review process and provides opportunities to create and evaluate benchmarking data.

62. Internal quality reviews are conducted by senior and appropriately experienced colleagues who have not been involved in the audits being reviewed.

The FRC's scoring methodology applied to quality activities

Grade	Standard	Description
1	 Good	We identified no areas for improvement of sufficient significance to include in our report.
2	 Limited improvements required	We identified one or more areas for improvement of limited significance.
3	 Improvements required	We identified one or more key findings requiring more substantive improvements.
4	 Significant improvements required	We identified significant concerns in one or more areas regarding the sufficiency or quality of audit evidence, the appropriateness of key audit judgments or another substantive matter such as auditor independence.

63. The AQF expects audits to be assessed as 'Good' (1) or 'Limited improvements required' (2) with no concerns about the audit opinion. Auditors are expected to address any findings. Where an audit is assessed as 'Improvements required' (3) or 'Significant improvements required' (4), the auditor is expected to put in place a plan to address the required improvements.

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

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

66. The target for the percentage of cold reviews showing good compliance with auditing standards (1 and 2) is 80 per cent cumulative over three years.

Type of review	Aggregate 3 year cumulative at target			Previous year's 3-year cumulative at target ¹
	Auditor General	Accounts Commission	Aggregate	Aggregate
Independent financial audit	64%	78%	70%	70%
Independent performance and Best Value audits	100%	100%	100%	100%
Internal financial audits	86%	88%	87%	80%
Internal performance and Best Value audits	80%	100%	80%	75% ²

Notes:

1. The changes to the numbers of audits falling within each grading from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For these reasons changes in the cold review results from one year to the next are not necessarily indicative of any overall change in audit quality and need to be considered in the context of other information available.

2. Where joint performance audits have been carried out by the Auditor General and the Accounts Commission these have been counted in both their separate results but only once in the aggregate result for internal performance audit and Best Value reviews.

Independent external reviews

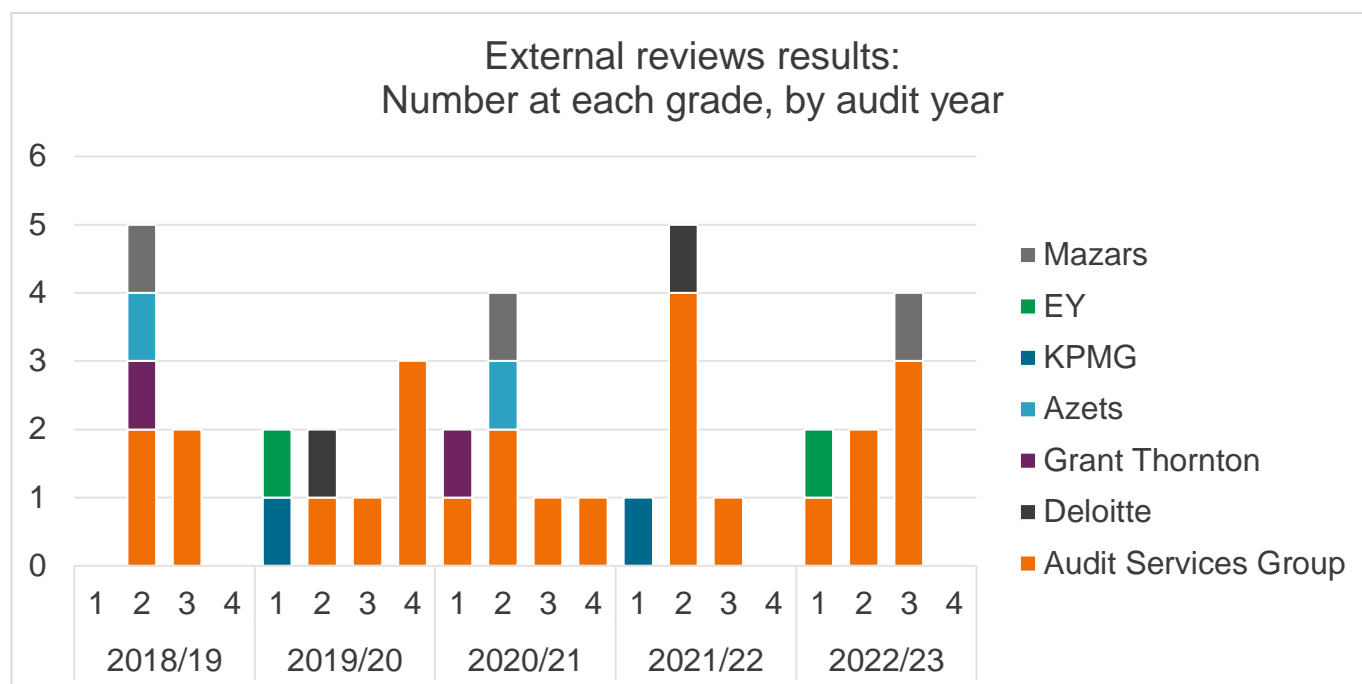
67. Independent external assurance offers the highest level of assurance to stakeholders. ICAEW replaced ICAS for 2021/22 independent reviews following a successful tendering exercise in 2022.

68. ICAEW reviewed 2022/23 audit files to assess the quality of audit work and compliance with the International Standards on Auditing (UK), Financial Reporting Council's Practice Note 10 and Audit Scotland's Code of Audit Practice. External reviews cover the firms and Audit Directors in Audit Scotland over a three-year cycle.

69. ICAEW assessed 50 per cent of 2022/23 financial audits reviews as 'good' or 'limited improvements required' (1 or 2) compared to 86 per cent of 2021/22 financial audits.

70. Over the last three years ICAEW and ICAS have assessed 70 per cent (70 per cent previous year) of financial audits as 'good' or 'limited improvements required'. The ICAEW and ICAS reviews of financial audits over this three-year period show the external auditors did not meet the aggregate three-year target of 80 per cent.

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



Audit Services Group

72. ICAEW reviewed six 2022/23 ASG audit files. ICAEW graded one financial audit as 'good' (1) and two financial audits as 'limited improvements required' (2). These three audits met the expected quality standards.

73. Three audits were graded as 'improvements required' (3) which is below the expected quality standard. ICAEW did not find any issues which impacted directly upon the auditors' opinion in the independent auditors' report. ICAEW also did not grade any ASG audits as 'significant improvements required' (4). The overall results represent a decline upon 2021/22, when four out of the five financial audits reviewed met the expected standard.

74. ICAEW also reviewed the work to support the wider scope responsibilities on five of the six financial audits. As this was the first period of review under the 2021 Code, ICAEW did not grade the wider scope audit work. Instead, ICAEW communicated any relevant findings and examples of good practice to the engagement teams and AQA. The sixth financial audit was not required to conclude on the wider scope.

75. ICAEW also performed one focused engagement review to follow up an audit that was found to require improvements during ICAEW's review of the 2021/22 audits. ICAEW found that the audit team had addressed the majority of ICAEW's previous concerns.

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

- The audit work conducted on the four wider scope areas in all the audits reviewed was consistently of a good standard, with no findings identified.
- Multiple examples of comprehensive and clearly documented audit work in the individual audits reviewed were identified.
- One of the audits reviewed used a schedule to document their approach to sampling at the planning which stage which helped to provide a greater understanding into the final conclusions of the completed sample testing.
- Two instances of appropriate, timely and well documented consultation with Professional Support on matters concerning modifications to audit reports.
- One example where the audit opinion clearly set out the judgement and basis for the regularity qualification.

77. The main thematic finding from ICAEW reviews was that more audit work is required by ASG to evaluate the appropriateness of management expert's work on non-current assets. This finding relates to several of the ASG audits reviewed by ICAEW. The audit work in this area should include:

- properly documenting an understanding of the expert
- testing the source data used by the expert for accuracy and reliability, and appropriate evaluation
- where applicable, challenge of the reasonableness of expert assumptions. ICAEW raised similar findings during their 2021/22 quality reviews in two of the five ASG audits
- lack of sufficient documentation of their understanding of the credentials of, or the work undertaken by, two internal management experts used by the audit body to value heritage assets.

78. The other key areas for improvement found by ICAEW were:

- Insufficient review by ASG of the working papers of the previous auditor:
 - ICAEW found that audit procedures over opening balances in most cases have been appropriately conducted but also identified several instances where audit teams have relied more specifically on previous year's audit work, but the review of predecessor auditor's working papers have not adequately considered some areas.

- Litigation and claims not adequately considered:
 - ICAEW found that the letter of representation obtained on all six audits did not include the litigation and claims representation required by ISA 501 (paragraph 12). For three of the audits, there was no other documented audit work carried out to obtain evidence over litigation and claims recorded on file.
- Weaknesses in ASG's audit planning procedures:
 - ICAEW found two separate instances where ASG's audit planning procedures did not comply with auditing standards. In one example, the audit team did not adequately document their understanding of the basis that the audit body's income streams were not materially under-stated. In a second instance, due to lack of communication between the audit team (as group auditor) and the component auditor, the audit team was unable to assess whether the materiality used by the component auditor for group purposes was appropriate.
- Insufficient appropriate audit evidence:
 - A lack of sufficient challenge of management over whether a significant change in use of an asset should have resulted in an impairment review.
 - Wholly relying on fund manager statements to provide assurance over the existence and valuation of investments.
 - No review of a component auditor's procedures linked to the significant fraud risk of management override.
 - Audit work on some estimates was limited to reasonableness checks.
 - Expenditure cut-off testing included three items above performance materiality, none of which were then selected for testing. The basis for their exclusion was not sufficiently justified.
 - Using a substantive audit procedure to get assurance over payroll costs, which did not adequately consider the impact of industrial action when developing their expectation.

Recommendation 2.

ASG need to prepare an action plan, including timescales, in response to the 2022/23 ICAEW review findings that is focussed on the areas that will improve audit quality.

Private firms

79. ICAEW and ICAS found that most of the accountancy firm audits met the expected quality standard of audits being graded as 'good' or 'limited improvements required' for the last five years.

80. ICAEW reviewed one 2022/23 audit for two private firms (EY and Mazars) this year.

81. ICAEW graded EY as 'good' (1), meeting the expected standard. ICAEW concluded that EY's work on the financial statements was conducted to a high standard without any major issues identified. ICAEW identified no principal findings on the work done in support of the auditor's wider scope and best value responsibilities. EY has consistently graded highly in all previous independent external quality reviews.

82. ICAEW graded Mazars as 'improvements required' (3), meaning that Mazars did not meet the expected standard. ICAEW stated that the grade was driven by gaps in audit work in the following areas:

- Failure to sufficiently challenge management's assumptions and address likely risks around a year-end provision which was an area of significant estimation.
- Several weaknesses in substantive analytical procedures when developing a suitable expectation model for staff expenditure.
- Weaknesses in the audit team's assessment of the potential impairment to carrying value of property, plant, and equipment.
- The team's risk assessment for wider audit work was not communicated to those charged with governance in a timely manner, which potentially limited the opportunity for those charged with governance to scrutinise the audit team's proposed approach to this work.

83. As part of ICAEW's review process, ICAEW sent a report to Mazars of their findings that require urgent attention by Mazars. Mazars has agreed the findings with ICAEW and stated in their response that they are committed to addressing the findings. Mazars' Root Cause Analysis (RCA) team will undertake a review of the findings to identify the underlying reasons for the failings in audit quality.

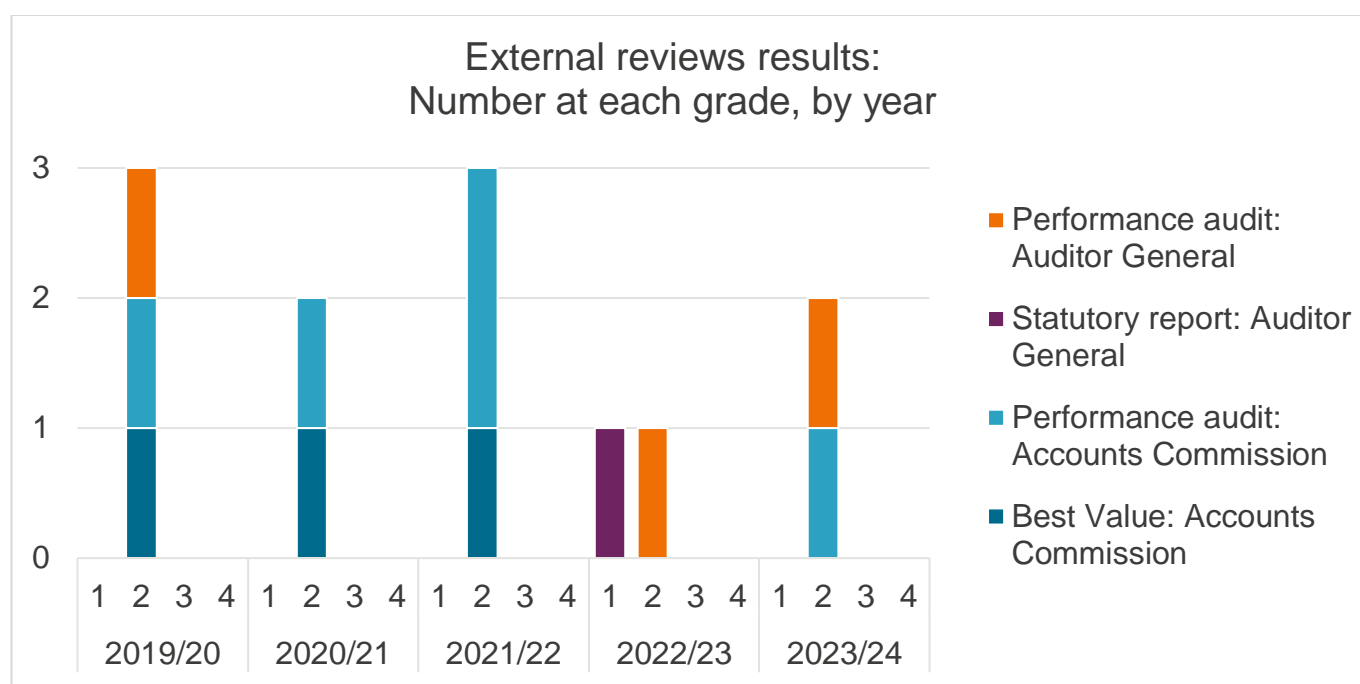
84. AQA will discuss this quality result with Mazars to establish what actions Mazars will take to improve the quality of their work in the future.

Recommendation 3.

Mazars need to prepare an action plan, including timescales, in response to the 2022/23 ICAEW review findings that is focussed on those areas that will improve audit quality.

Performance audits and Best Value audits

85. ICAEW reviews of Audit Scotland's performance audits aim to cover work prepared on behalf of the Auditor General for Scotland and the Accounts Commission, as well covering different product types and PABV Audit Directors. The performance audit reviews consider the content of the report, the likely impact of any recommendations made, aspects of the reports consistency with the evidence obtained and compliance with the International Organisation of Supreme Audit Institutions (INTOSAI) standards.



86. ICAEW reviewed two performance audits during the year and graded both reviews as 'limited improvements required' (2). These results mean that this is the fifth year that performance reports have met the expected standard for the quality of their audit work, being graded as 'good' or 'limited improvements required'.

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

- Both reports had examples of structure, wording and linking which enabled the understanding and accessibility of the reports.

- The performance audit team's record of evidence was well documented and clearly referenced.
- The performance audit team's key decisions and approvals log provided a clear trail of the quality control procedures applied to the engagement.

88. ICAEW reviewers also identified several areas where further improvements could be made, which included:

- On both files, the audit teams did not sufficiently document their assessment of fraud or consideration of materiality.
- One of the audits was the third in a series of overview reports. The audit team did not document following up on progress made against the recommendations made in the previous reports. ICAEW raised a similar finding on another engagement at their previous visit.
- The audit team could have documented some elements of the evidence log more comprehensively. ICAEW found several examples where documentation linked to the evidence log was inconsistent with the report narrative.

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

ICAEW Audit Scotland summary

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



ICAEW undertook eight cold file reviews of financial audits, six covering Audit Scotland and two covering a sample of the six appointed firms. In addition, a further focused cold file review covering Audit Scotland was conducted to follow up issues in a file that required improvement at our previous visit. Two performance audits, both conducted by Audit Scotland were also inspected.

The quality of audit work, across financial and performance audits, was of a generally good standard. On the financial audit files reviewed, four of eight files reviewed achieved this grade, including two files graded as good. The one significant thematic area identified, relevant to several engagements conducted by Audit Scotland, relates to improving audit work over the valuation of non-current assets. The area requiring improvement on the appointed firm relates to sufficiently challenging key assumptions on a significant year-end provision. The performance audits were both generally of a good standard.

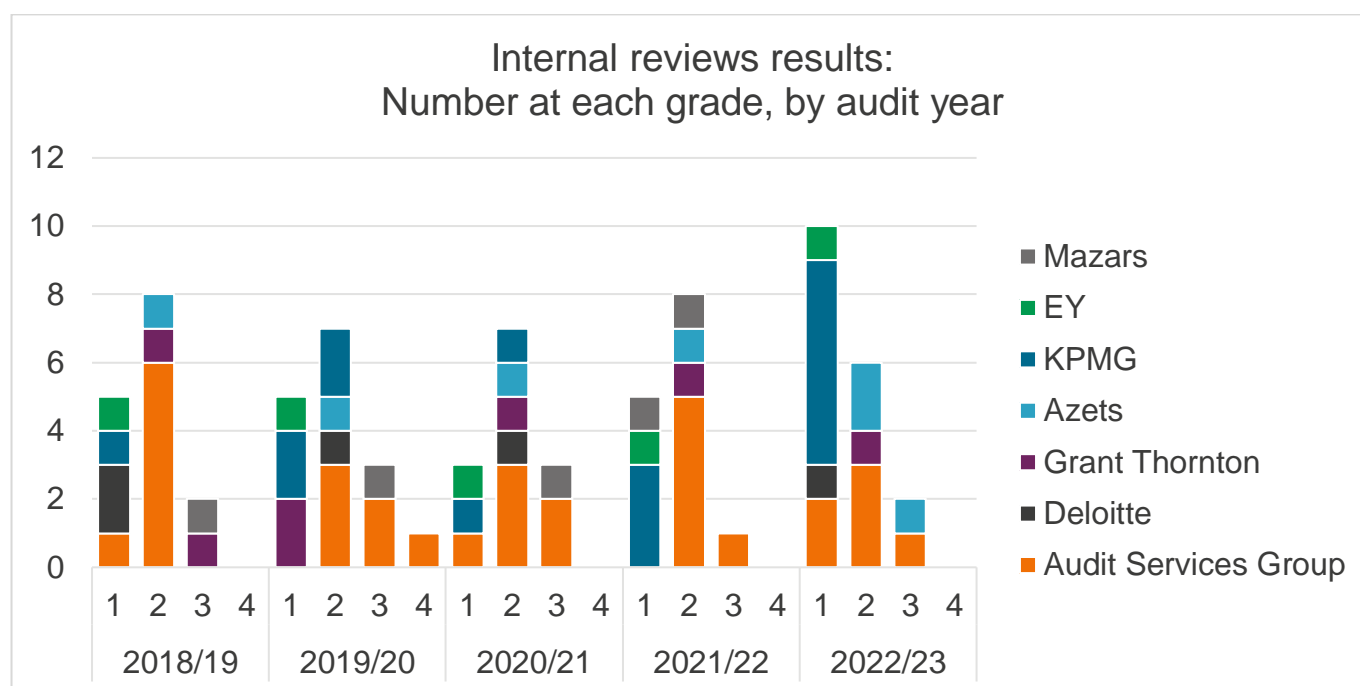
We also reviewed audit work to support the wider scope responsibilities on seven of the eight financial audit files to assess compliance against the requirements of the 2021 code of audit practice. Only one finding, on an engagement conducted by an appointed firm, was identified in this area. For the one financial audit where the assessment was not undertaken, wider scope was not applicable.

The responses of both Audit Scotland and the appointed firm, which includes plans to conduct detailed root cause analysis on files that require improvement, demonstrate they are intending to take appropriate action to address all the findings raised.

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

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

Internal cold reviews carried out by appointed auditors



90. Internal audit quality reviewers assessed 89 per cent of 2022/23 financial audits as 'good' or 'limited improvements required' (1 or 2, 92 per cent of 2021/22 financial audits).

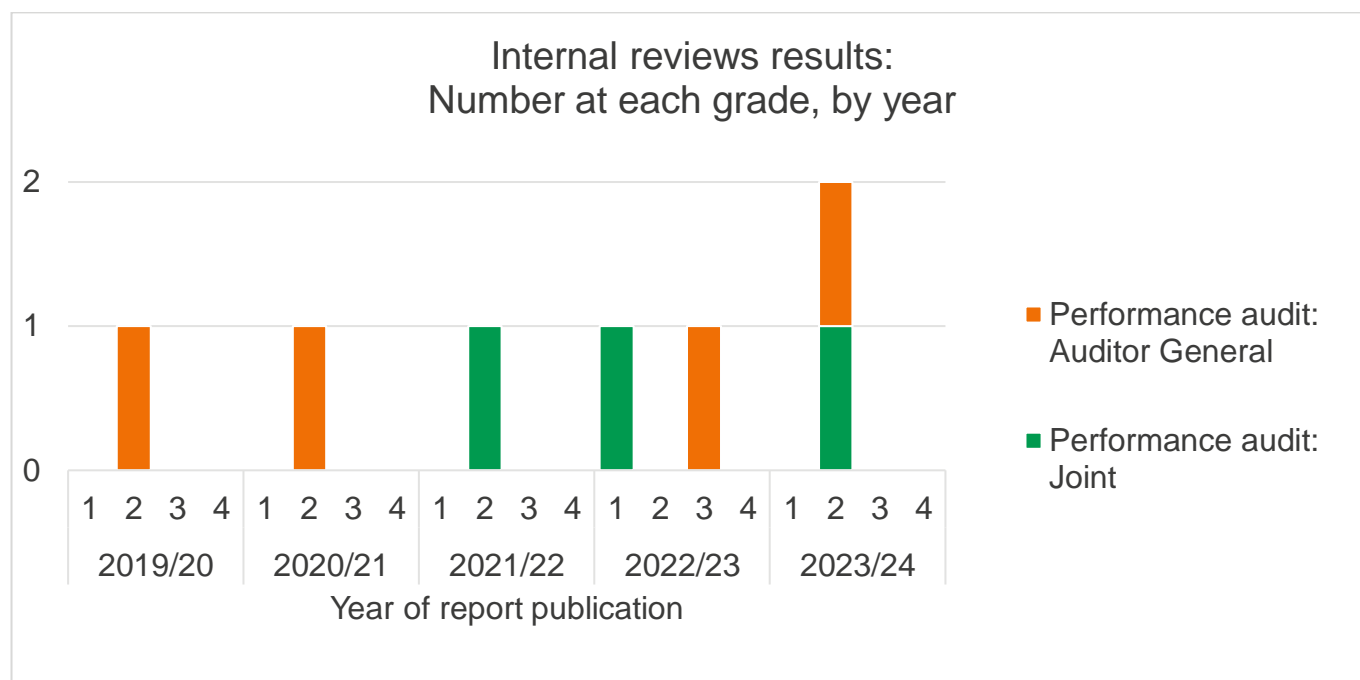
91. The overall aggregate three-year grading for internal quality reviews of financial audits was 87 per cent (80 per cent in 2021/22). Internal reviewers did not identify any concerns with audit opinions for 2022/23 or find any audit required significant improvements (grade 4).

92. Audit Scotland conducted six internal quality reviews of 2022/23 financial audit work. One was graded 'good' (1) and four were graded 'limited improvements required' (2) and met the expected quality standard. The sixth internal review was graded as 'some improvements required' (3) and did not meet the expected standard. The review found that the quality of the audit work required some improvement regarding the risk assessment and understanding of financial IT applications and the control environment, and some aspects of substantive work in relation to pension estimations and journals testing.

93. Azets conducted three internal quality reviews of 2022/23 financial audit work. Two were graded 'limited improvements required' (2) and met the expected quality standard. The third internal review was graded as 'some improvements required' (3) and did not meet the expected standard. The review found that the quality of the audit work required some improvement in relation to property, plant and equipment valuations.

Internal reviews carried out by PABV

94. Audit Scotland's internal quality review team carried out two internal cold reviews of performance audit reports published in 2022/23 (two in 2021/22). Both reviews were graded as 'limited improvements required'. The quality reviews highlighted good practice, including engaging with people with lived experience by setting up focus groups to provide context for the audit findings and the audit team made good use of data analytics.



Improvement feedback for auditors

95. Auditors received detailed reports on each audit reviewed. Root cause analysis and action plans should be developed by auditors to include improvement areas identified. Good practice areas should be shared to ensure auditors are aware of and adopt practice that meets professional

standards. AQA will monitor how well the action plans are delivered as part of their regular meetings with auditors. Audit Scotland, working together with all auditors through sector meetings, will continue to share best practice to support improvements in the quality of public audit in Scotland.

Review of annual audit reports

96. AQA reviewed 32 2022/23 annual audit reports (AARs) for compliance with the requirements of the [2021 Code of Audit Practice](#), [Guidance on planning the audit 2022/23](#) and [International Standards on Auditing \(UK\)](#) (ISAs (UK)).

97. The sample was selected to give a good representation of all sectors and auditors. The reviews covered financial audit work; wider scope and best value audit work; the quality of the recommendations made by auditors; and an overall assessment of the readability and understandability of the AARs.

98. The majority of the AARs (85 per cent) demonstrated a high level of compliance with the Code and related guidance. Examples of good practice included:

- Clear narrative on the significant financial and wider scope risks and other key audit matters and how these were addressed by the auditor.
- Well written, balanced annual audit reports that explains to the reader, the audit process from planning to completion in a clear and concise manner.
- Recommendations that when implemented will assist the audit bodies to further improve their governance arrangements.

99. We also found the following areas where AARs could be improved. The recommended improvements are:

- Deloitte, KPMG and Mazars should ensure that all their AARs contain a reference to the level of performance materiality that has been set and how this was applied by the auditor in their audit of the accounts.
- Azets, KPMG and Mazars should ensure that all their AARs contain a clear conclusion on the effectiveness of arrangements by the accountable officer to secure Best Value for central government, NHS, and further education bodies.
- Mazars and Grant Thornton should ensure that all recommendations have an agreed target date and responsible officer for implementing recommendations.

- Mazars and KPMG should improve the clarity of judgement on wider scope areas to ensure they go beyond descriptions of the arrangements in these areas.

100. We have discussed the areas for improvements, along with the areas of good practice, with the relevant auditors.

Impact

Audited bodies' views on audit work

Feedback on the annual audit from audited bodies continues to show a high level of satisfaction with 87 per cent of respondents considering the annual audit to be fairly or very useful. Satisfaction has continued to decrease slightly from the highs of 2019/20 and 2020/21 and is now back to 2018/19 levels. Meanwhile perceptions of the quality and usefulness of performance audit outputs have improved slightly.

101. The Diffley Partnership was commissioned in 2023 to undertake the annual independent stakeholder feedback survey. It surveyed 501 individuals (472 in 2022/23) in audited bodies to gather feedback on the 2022/23 financial audits and Performance audit outputs published in the past year. There were 247 complete responses (49 per cent, 42 per cent 2021/22). Audited bodies were asked to respond to questions using a scale of 1 to 5 where 1 is 'very poor' and 5 is 'very good'.

102. We analyse responses by using the Mean score. This is the average of respondents' views on a question within a particular category, either by sector or auditor. We aim for auditors to receive a mean score of 4.0 which equates to 'good.' Where scores fall below this level, we investigate the reasons and, if necessary, discuss these with the auditor to ensure action is taken to improve performance.

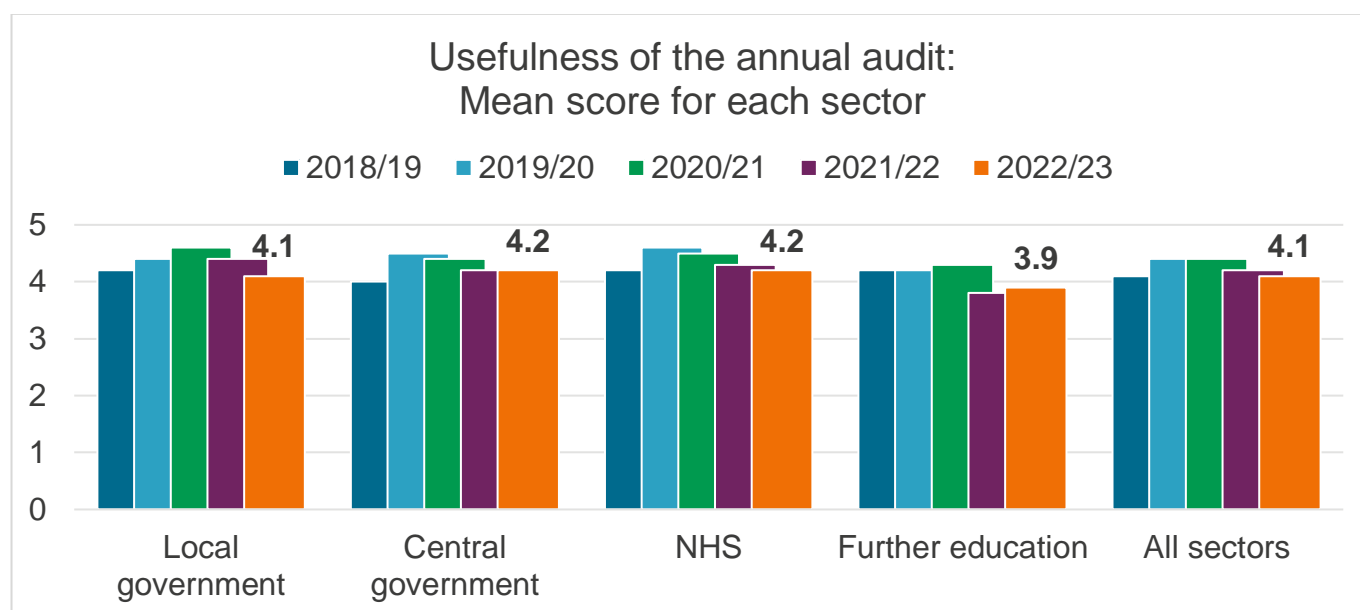
Financial audit

103. The 2022/23 audits were the first conducted after the appointment of new auditors, meaning almost all audit teams were rotated resulting in new audit teams conducting the audits for the next five years. We asked how audited bodies' auditors managed the handover of audits. Almost two-thirds (65 per cent) had a positive perception of the handover process, however, almost a fifth (19 per cent) felt the handover did not go well leading to a Mean score of 3.8.

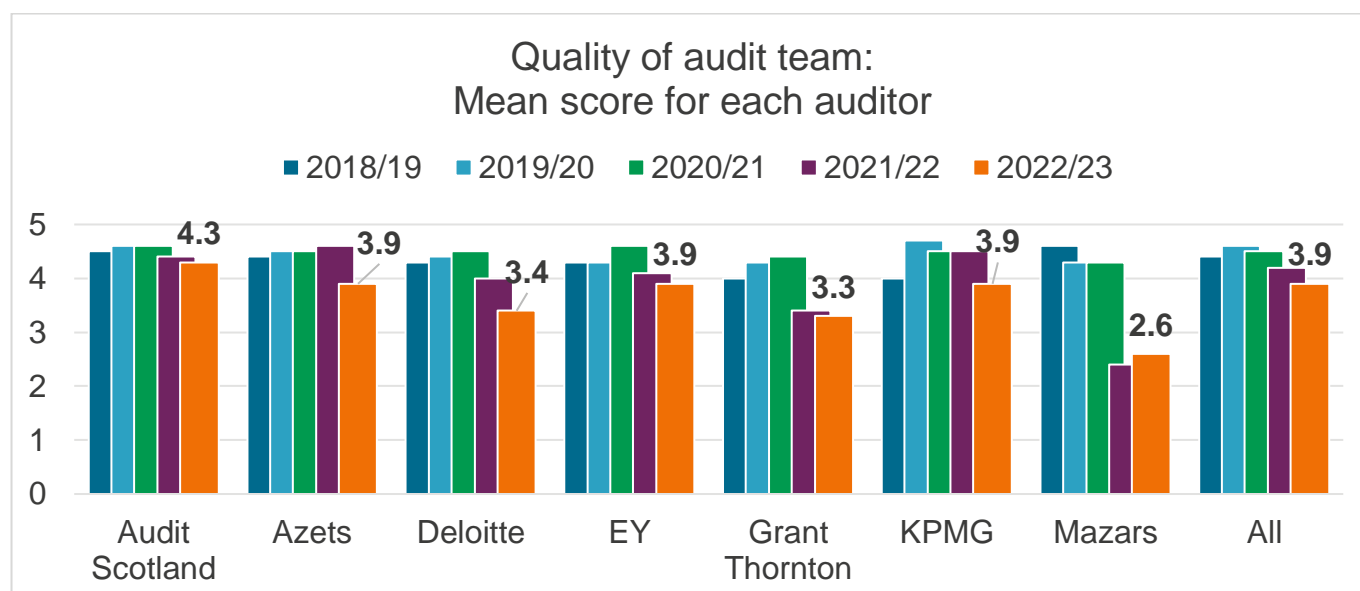
'Overall, we have a very good experience.... The first year of a new auditor can be difficult, however, the audit was completed to time and we felt like a very robust audit had been undertaken. [New audit team] had a very different auditing approach [than our previous auditor] which took time to get used to.'

(Central government)

104. Audited bodies' views on the usefulness of the annual audit have continued to decline from the highs observed in 2019/20 and 2020/21, during which time nearly 60 per cent of respondents considered the annual audit to be very useful. The levels have returned to those seen in 2018/19. In all, 87 per cent of respondents considered the annual audit to be fairly or very useful with a Mean score of 4.1. Where respondents had a positive view of the handover, they were more likely to say that the annual audit was useful or very useful.

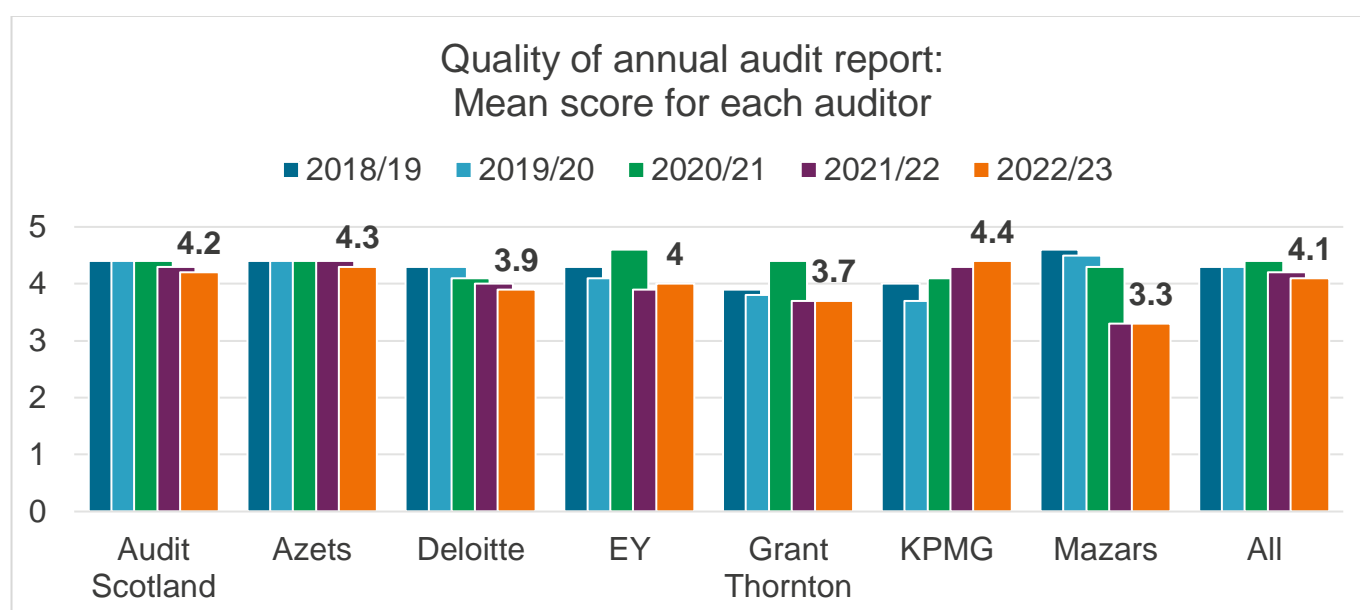


105. Audited bodies' views about the quality of the audit team followed a similar slight reduction to views on the usefulness of the annual audit. Around two thirds of respondents (68 per cent) believe the audit team performed very or fairly well with a Mean score of 3.9. Views on the quality of the audit team were significantly influenced by whether the audit was completed on time (4.1) or not (3.7). Where respondents had a positive view of the handover, they were more likely to say that the audit team performed well or very well.



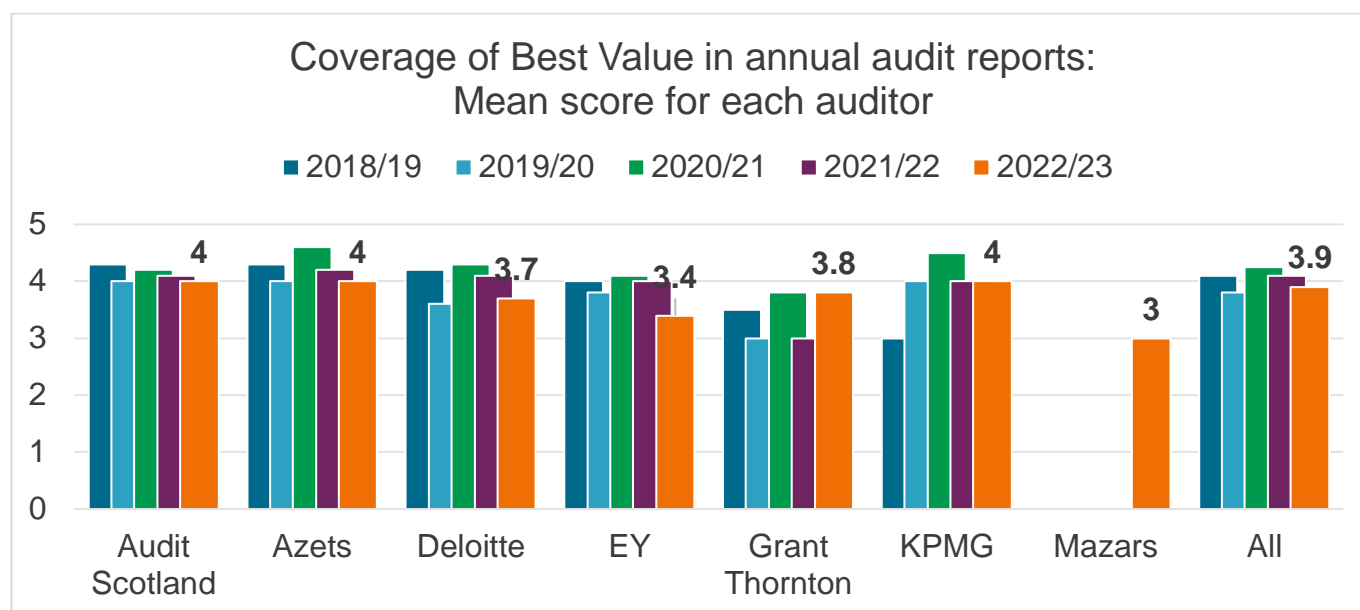
106. Three quarters of respondents find the annual audit report useful (74 per cent) with a mean score of 4.1. The usefulness of the annual audit report continues to score well but it continues to decline from the high observed in 2021/21 (87 per cent). There is no significant change since 2021/22 but those which fell in 2021/22 have remained lower.

107. A new question this year asked how well the annual audit report makes useful recommendations that help to influence improvement. Where respondents had a positive view about the annual audit report, they were more likely to say that the recommendations were useful or very useful. This suggests that the recommendations are a critical element in how readers assess the usefulness of the annual audit report.



108. Local government auditors are required to assess and report on audited bodies' performance in meeting their Best Value and community planning duties. Audited bodies were asked how well auditors covered Best Value in their annual audit report.

109. Mazars' portfolio includes local government audits for the first time in 2022/23 and many of their audits are delayed. This means that the number of respondents is very small, so the result is particularly sensitive to one or two poor results.



110. Respondents commenting on the annual audit report often talked about the report providing assurance, support, and improvement showing that the audit report is viewed by organisations as providing assurance with an eye towards helping the organisation improve.

‘Confirmed where progress had been made, which has a positive impact on morale and assurance, and confirmed areas for attention in the year ahead, which provides focus and measurable plans.’

(Central government)

111. In contrast, where respondents were more negative they often talked about delays and difficulties related to the audit process and the final report overall.

‘The draft was reasonably well received at the time (September 2023). However, a final report is still awaited which undermines the usefulness of the exercise.’

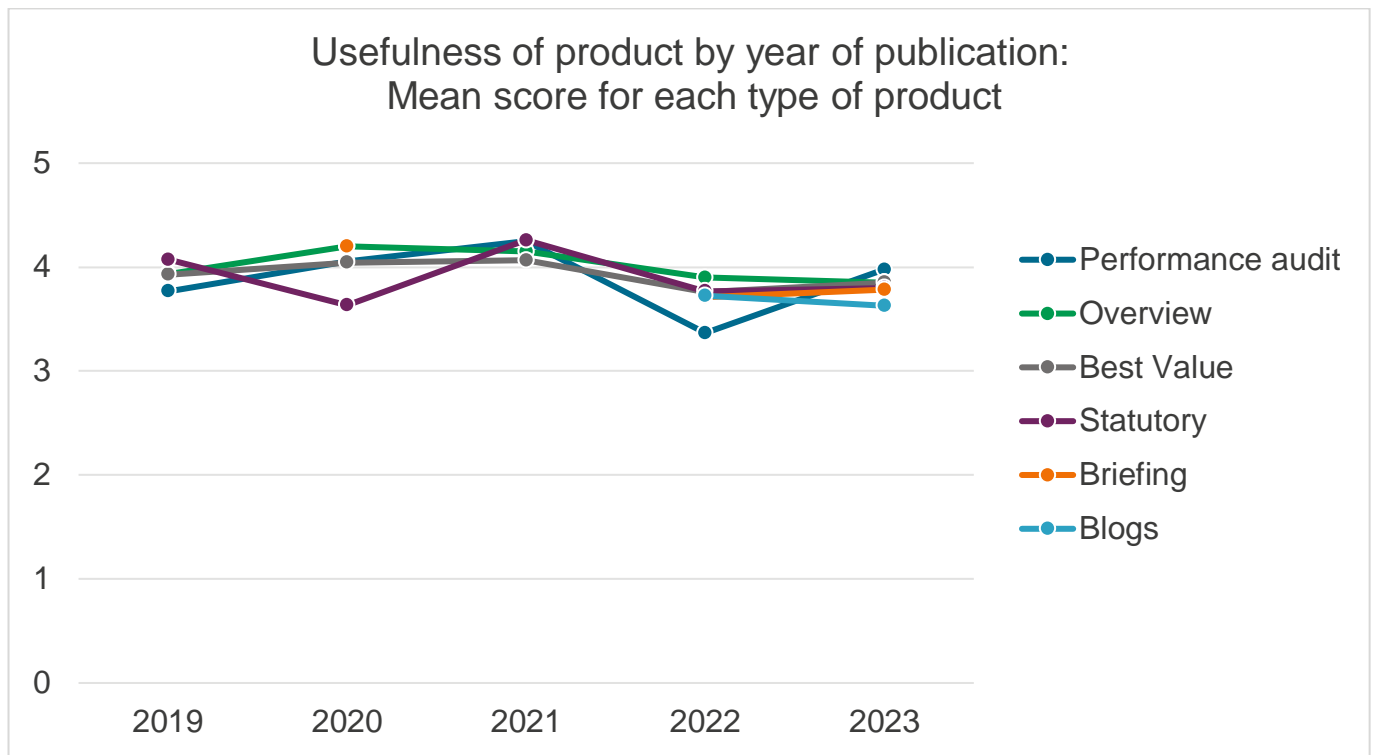
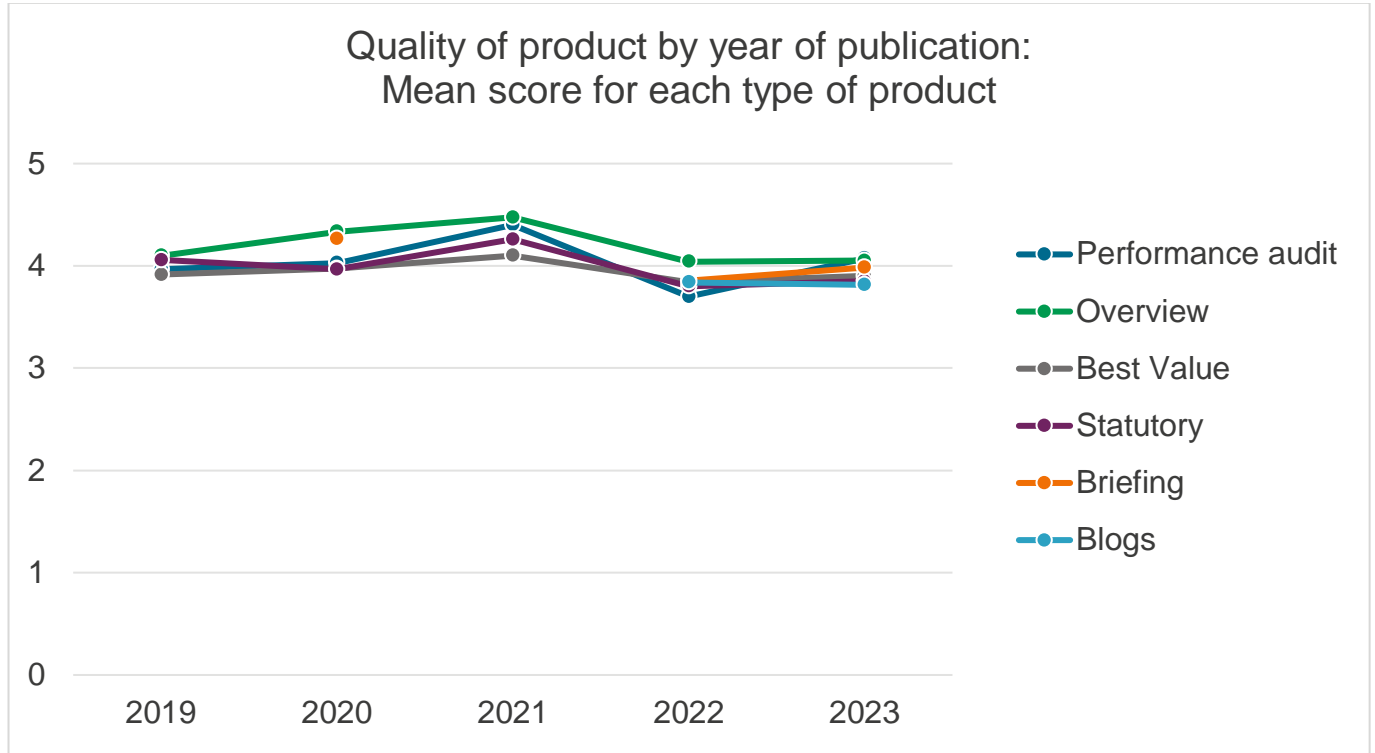
(Local government)

Performance audit outputs

112. Audited bodies were asked for their views on the quality and usefulness of outputs published by Audit Scotland in 2023 that they had read. Factors indicating quality included if a report is comprehensive, convincing, timely, reader-friendly, and balanced. Factors indicating usefulness included if the report provides assurance, focuses on relevant area for development, makes useful recommendations for improvement, and influences improvement.

113. Perception of the quality and usefulness of performance audit outputs published in 2023 improved slightly over 2022. The mean score for the quality and usefulness of outputs was 3.9 and 3.8 respectively

(3.9 and 3.7 for outputs published in 2022). The usefulness of performance audits has improved the most, from 3.4 to 4.0 resulting in all types of report now viewed at a similar level. The most highly rated report in 2023 was the [Criminal courts backlog](#) which was assessed a 4.5 in both quality and usefulness.



Adding value

114. The Auditor General, the Accounts Commission and Audit Scotland have a shared vision, mission and outcomes for public audit that will strengthen the impact of the public audit partnership by giving a shared purpose and focus for audit work.

115. The audit process provides assurance that money is spent as intended and that the accounts are true and fair, but auditors seek to provide value beyond this. Examples of these include:

- Making recommendations for improvements to processes within the body, such as recommending:
 - a new programme structure and approach to change management in a body implementing a new Enterprise resource planning system or
 - improvements in climate change preparedness and the establishment of effective performance measurement area so that national climate change priorities can be accurately tracked.
- Supporting or facilitating learning about technical matters such as the new lease accounting standard or how to account for the pension assets this year. In some cases, this included inviting staff from audited bodies to sectoral workshops or technical training.
- Sharing intelligence from other work, such as national reports by Audit Scotland or the firms' own sectoral or cross sectoral reports, or relevant reports by the National Audit Office. In some cases, the auditor pulls out the information most relevant to the body.
- Meeting with audited bodies either before or after the audit to set expectations and learn what could be done by each side to improve the quality of the audit process.
- Attending regular audit committees to contribute beyond the audit, to the wider items on the Audit Committee agenda and bring sector knowledge and recommended practice.
- Engaging with Audit Scotland through sector meetings, responding to consultations, and highlighting emerging risks so that auditors develop a consistent approach to key developments.

4. Areas for improvement and wider audit profession focus

Areas for improvement

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

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

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

- **Audit work on the valuation and existence of non-current assets.** ICAEW found that for ASG audit testing needs improvement in this area to enable reliance on work conducted by management experts supporting the valuation of various non-current assets.
- **Challenge of key assumptions in a significant year-end provision.** ICAEW found that for Mazars improvements could be made by the audit team in sufficiently challenging management assumptions and address likely risks around a significant year-end provision.

FRC audit inspections 2022–23

119. The FRC and ICAEW quality review work provide useful benchmarks for comparing the audit quality review findings for public audit in Scotland.

120. In July 2023, the FRC released its latest audit quality reviews reports, covering seven Tier 1² firms' audit work in the private sector, for their 2022/23 inspection cycle. All seven audit firm reports can be found on the [FRC's website](#) (five of these firms are appointed to conduct public audit in Scotland).

² The Tier 1 audit firms currently comprise the largest audit firms: BDO LLP, Deloitte LLP, Ernst & Young LLP (EY), Grant Thornton UK LLP (GT), KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP (PwC). Out of these audit firms, BDO LLP and PwC LLP are not appointed to carry out public audit in Scotland.

121. The [FRC's 2022/23](#) results show that audit quality continues to improve at the largest audit firms and on the largest audits. Of the audits inspected, 77 per cent were categorised as 'good' or 'limited improvements required' (audit quality grades of 1 or 2). This is an improvement on the last two years (up from 75 per cent and prior to that 71 per cent).

122. In December 2023, the FRC also published its report on the audit quality inspection of [Major Local Audits](#), which covers the audits of local government and NHS bodies in England. This audit work was conducted by six large audit firms, five of whom are also appointed to conduct audits of Scottish public sector bodies.

123. The FRC found that 100 per cent of financial statements audits required no more than 'limited improvements required', compared to 70 per cent in the previous year. However, the FRC could only review 10 audits because of the large number of audits of public bodies in England that have not been completed (in the last two audit review cycles the FRC had reviewed 20 audits each year).

124. As a result of this backlog the FRC is proposing that they will not routinely conduct audit quality inspections of local government audits in England for financial years up to and including the year ended 31 March 2023, unless there is a clear case in the public interest to do so. The FRC plans to resume a programme of routine audit quality inspections once the backlog has been cleared. The FRC plans to continue to inspect a sample of NHS audits in England.

Audit quality inspections conducted by chartered accountancy bodies

125. In December 2023, the ICAEW published its [audit monitoring report](#) for 2022/23. ICAEW's report shows that 95 per cent (90 per cent in 2021/22) of audits reviewed at the largest seven firms in 2022/23 were rated as 'good' or 'limited improvements required'. This was the best set of results ever for these firms. There was, however, a slight dip in the quality of audits reviewed in 2022/23 across all firms, with 71 per cent of audits being rated 'good' or 'limited improvements required', compared to 76 per cent in 2021/22. The key messages from the report are:

- The investments made by the larger audit firms are paying off in improving audit quality results. However, it may be that, in terms of audit quality, there is a divide between the larger audit firms and the rest.
- Audit firms should build on their implementation of ISQM1 to continue to drive further improvements. The ICAEW believes that ISQM1 provides an opportunity for audit firms to build upon and improve their processes for ensuring audit quality even further in the future.
- All audit firms should continue to challenge themselves by asking themselves questions such as: have we got the right processes in

place, do we need to change anything, are we undertaking the most effective monitoring and remediation activities, including internal or external cold file reviews, what do the findings of our root cause analysis tell us, and are there any other areas of improvements?

Wider issues that impact the audit profession

126. There is growing evidence that audit fees are increasing across both the private and public sectors. A recent survey conducted by the Quoted Companies Alliance, an umbrella group for smaller companies listed on the UK stock market, states that audit fees have increased by 127 per cent for their members during the last five years. The FRC is also reporting in their [Key Facts and Trends in the Accountancy Profession](#) that audit fees increased by 7.6 per cent for largest four audit firms in 2022 and 23.3 per cent for the other audit firms. In the public sector there is also evidence of rising audit fees. [Public Sector Audits Appointments](#) (PSAA), the organisation responsible for appointing auditors for local government and NHS bodies in England, has increased the new contract rates for audit firms by 151 per cent for 2023/24 public sector audits compared to 2022/23.

127. There is also some early evidence that indicates that financial audit may be becoming a less attractive option for chartered accountants when choosing their future career paths. The [FRC's data](#) shows that the number of audit firms registered to carry out statutory audit work has fallen by 20 per cent between 2018 and 2022 (from 5,394 to 4,310).

128. Increasing audit fees and a declining number of registered statutory auditors are both likely to impact upon the market for the audit of Scottish public sector bodies in the future. AQA will continue to monitor these issues.

FRC publishes thematic review of audit sampling

129. In November 2023 the FRC published its [thematic review of audit sampling](#). Audit sampling is a methodology which allows auditors to draw conclusions about a population of items as a whole, based on the sample selected. The FRC reviewed the sampling methodologies of the largest audit firms to identify areas of good practice and to highlight any concerns that will drive improvements and support our monitoring of the firms' systems of quality management. The review found all audit firms should:

- Ensure that they provide engagement teams with sufficient guidance and training to support their use of professional judgement in audit sampling.
- Update their methodologies and guidance to drive better documentation of key professional judgements in this area.

130. The FRC's review also strongly encourages the use of random (or statistical) sampling methodologies over haphazard sampling methodologies.

5. International Standard on Quality Management (UK) 1

Implementation of International Standard on Quality Management by Audit Scotland and audit firms

131. [ISQM1](#) deals with an auditing firm's responsibilities to design, implement and operate a system of quality management for audits. ISQM1 replaced the previous standard, International Standard on Quality Control (UK) 1, on 15 December 2022. ISQM1 emphasizes that the public interest is best served by auditors if they consistently perform audits to a high level of quality.

132. ISQM1 required all audit firms to implement a system of quality management by 15 December 2022. It also required each firm to evaluate the effectiveness of their system of quality management within one year, that is, by 15 December 2023.

133. As part of our responsibilities to monitor and report on audit quality to the Auditor General of Scotland and the Accounts Commission, AQA prepared a questionnaire for the six appointed audit firms and Audit Scotland to complete.

134. Audit Scotland's framework agreement with the firms and letters of appointments with auditors from Audit Scotland's Audit Services Groups states: that they should submit when requested information about the arrangements in place to meet the requirements of the FRC's international standards of quality management currently in force.

135. As well as aiding AQA to appraise the audit quality and Audit Scotland, the questionnaire also assisted firms and Audit Scotland as they evaluate and improve their systems of quality management. The questionnaire comprised eight sections, based upon the ISQM1's eight components of a good system of quality management:

- Risk assessment process
- Governance and leadership
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements

- Engagement performance
- Resources
- Information and communication
- The monitoring and remediation process.

136. We assessed each of the completed questionnaires against the requirements of ISQM1. Our primary aim was to evaluate whether the firm had considered and implemented the specific requirements of ISQM1. This review will be used alongside other evidence, primarily the quality reviews conducted by ICAEW and internally by each of the firms to provide overall assurance over the quality arrangements of each firm and Audit Scotland.

Results

137. Our assessment found that all the audit firms and Audit Scotland have fully implemented the requirements of ISQM1 by the due date of 15 December 2022. They also evaluated the effectiveness of the system of quality management within one year, and before the 15 December 2023 deadline.

138. Our conclusions are supported by ICAEW's Quality Assurance Department who reviewed Audit Scotland's organisational audit quality processes. In their 2024 report to Audit Scotland, ICAEW stated: 'Audit Scotland's system of quality management (SoQM) continues to be generally appropriate for the size and nature of the organisation. It has made appropriate progress in implementing the next phase of ISQM1'.

139. Our review also found several areas of good practice which included:

- All auditors stated that they had conducted a thorough risk assessment process to identify risks to their ability to consistently conduct audits that fully comply with the international auditing standards.
- All auditors' responses emphasised the importance of quality management and continuous improvement in implementing ISQM 1. This is important as the new standard represents an important shift in expectations of audit procedures within firms, with a more proactive, iterative approach to maintaining audit quality than its predecessor.
- All the auditors' leadership teams have taken responsibility for fully implementing the requirements of ISQM1. ISQM1 emphasises the important role of leadership for taking responsibility and accountability for improving audit quality.










Going forward







140. ISQM1 requires that the firm evaluates the system of quality management once a year and concludes whether it provides the firm with reasonable assurance the system of quality management is achieving its objectives. All auditors have stated that they intend to do this.




141. In July 2021, the FRC issued International Standard on Quality Management (UK) 2 (ISQM 2). ISQM2 builds upon the requirements of ISQM1 and specifically deals with the appointment, eligibility and responsibilities of an engagement quality reviewer relating to the performance and documentation of an engagement quality review. ISQM2 is effective for audits of financial statements for periods beginning on or after 15 December 2022.

142. To drive further improvements across all areas of audit, we urge firms and Audit Scotland to continue to build on their implementation of ISQM1 and fully implement the requirements of ISQM2.




Appendix

KPI	Target	Actual	Conclusion
Value of non-audit services carried out during the audit year. (Paragraphs 28. to 30.)	Steady or declining value	£19k representing 0.07 per cent of total fees during the 2022/23 audits (£58k representing 0.26 per cent of total fees during 2021/22 audits)	 Target met
Percentage of audit providers confirming compliance with ethical guidance. (Paragraph 27.)	100%	100%	 Target met
Percentage of audit staff with appropriate qualifications and in training. (Paragraphs 37. to 38.)	100%	100% for private firms	 Target met
		96% for Audit Scotland	 Target not met
Number of training and development days delivered per member of staff. (Paragraphs 39. to 40.)	Steady or increasing	14 days (14 days 2022/23)	 Target met
Percentage of cold reviews showing good compliance with auditing standards. (Paragraphs 67. to 93.)	80% Cumulative over 3 years	ICAEW/ICAS financial audits: 70%	 Target not met
		Internal financial audits: 87%	 Target met
		ICAEW/ICAS PABV audits: 100%	 Target met
		Internal PABV audits: 80%	 Target met

KPI	Target	Actual	Conclusion
Percentage of audits completed on time. (Paragraphs 42 to 47.)	95%	44% (49% for 2021/22 audits)	 Target not met
Percentage of audits with material prior period adjustments due to error. (Paragraphs 48. to 51.)	Less than 10%	11% (6.7% for 2021/22 audits)	 Target not met
Percentage of Performance Audit and Best Value assurance reports published as planned. (Paragraphs 56. to 59.)	90%	96% (96% for 2022/23)	 Target met
Perception of the usefulness of the audit overall (Paragraphs 104 to 107.)	4.0	4.1 (4.2 for 2021/22 audits)	 Target met
Perception of the appropriateness of coverage of Best Value (LG only). (Paragraphs 108. to 109.)	4.0	3.9 (4.1 for 2021/22 audits)	 Target not met
Perception of the quality of:			
• Overview reports	4.0	4.1 (4.0 for 2022 outputs)	 Target met
• Performance audits	4.0	4.1 (3.7 for 2022 outputs)	 Target met
• BV	4.0	3.9 (3.8 for 2022 outputs)	 Target not met
(Paragraph 113.)			

KPI	Target	Actual	Conclusion
Perception of the usefulness of:			
• Overview reports	4.0	3.9 (3.9 for 2021/22 audits)	 Target not met
• Performance audits	4.0	4.0 (3.4 for 2022 outputs)	 Target met
• BV	4.0	3.9 (3.8 for 2022 outputs)	 Target not met

[\(Paragraph 113.](#)

Staff survey results:	Steady or increasing		
• I am encouraged to carry out a high-quality audit		90% (94% 2022/23)	 Target met
• The time and resources available to me enables the delivery of a high-quality audit		61% (61% 2022/23)	 Target met
• The training and development I receive enables a high-quality audit.		75% (77% 2022/23)	 Target met

[\(Paragraphs 32. to 36.](#)

Quality of public audit in Scotland

Annual report 2023/24



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