



Healthcare Improvement Scotland

Report to the Audit and Risk Committee and Board
and the Auditor General for Scotland on the 2017/18 audit

Issued on 1 June for the meetings on 21 and 27 June 2018

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Introduction

The key messages in this report

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our final report to the Audit and Risk Committee of Healthcare Improvement Scotland ('HIS') for the 2017/2018 audit. The scope of our audit was set out within our planning report presented to the Committee in December 2017.

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the wider scope requirements of public sector audit. This includes our consideration of the Accountable Officers' duty to secure best value. As set out in our plan, due to the relative size and scale of the functions delivered by HIS, we concluded that the full wider scope audit was not appropriate. In accordance with paragraph 53 of the Code, our work in this area was restricted to concluding on:
 - The appropriateness of the disclosures in **the governance statement**; and
 - The **financial sustainability** of Healthcare Improvement Scotland and the services that it delivers over the medium to longer term.

Introduction (continued)

The key messages in this report – financial statements audit

I would like to draw your attention to the key messages of this paper in relation to the audit of the financial statements:

Conclusions from our testing

- The significant risks, as identified in our audit plan, related to:
 - Achievement of expenditure resource limits;
 - Management override of controls; and
 - Revenue recognition – completeness of income from independent clinics.
- A summary of our work on the significant risks is provided in the dashboard on page 8. HIS met all its financial targets for 2017/18.
- No audit adjustments have been identified from our procedures to date. One minor disclosure adjustment was identified in the remuneration report which has been corrected by management.
- The performance report and accountability report comply with the direction issued by Scottish Ministers which requires compliance with the Government Financial Reporting Manual (FReM) and the requirements of the NHS accounts manual; and are consistent with the financial statements and our knowledge of HIS. Whilst it is important for the annual report to clearly articulate the achievements and future plans, there is scope to reduce the level of detail disclosed. This would help ensure the main messages are not lost, in accordance with the series of best practice notes published by Audit Scotland. For example, the overview section could be reduced to set the scene and summarise issues, with the detail expanded within the analysis section. Currently the overview section is almost the same length as the analysis. The use of infographics, charts and graphs could assist with this. We acknowledge that the unique nature of HIS could require more detail to be disclosed to ensure fully understood by the reader.
- The auditable parts of the remuneration report have been prepared in accordance with the relevant regulation.
- Based on our audit work, we expect to issue an unmodified audit opinion.

Insights

- We have utilised Spotlight, Deloitte's patented analytics tool, to perform analytics on the journal entries posted in the year to profile the journal population which has helped us identify journals of audit interest, such as journals posted on non-business days or journals with key words. No issues were noted from this testing.

Status of the audit

- The audit is substantially complete subject to the completion of the following principal matters:
 - Receipt of final financial statements;
 - Receipt of signed management representation letter; and
 - Our review of events since 31 March 2018.

Introduction (continued)

The key messages in this report – wider scope

The following sets out the key messages of this paper in relation to the wider scope work:

Financial sustainability

HIS continues to face a challenging financial position, however all financial targets in 2017/18 have been met as summarised below. The HIS budget for 2018/19 is projecting £1.98m of savings that need to be achieved in order to achieve a balanced position. £0.400m of this balance has been classified as high risk. HIS has also reported a funding gap of £0.367m in 2019/20, increasing to £0.739m by 2020/21.

The requirement for National Boards to provide £15m collaborative and recurring efficiency savings has been agreed but the delivery of the £15m is not yet fully defined. For planning purposes, HIS have assumed a contribution of £0.600m, in line with 2017/18.

2017/18 final outturn position reported an under spend of £0.267m (1%) against core Revenue Resource Limit (RRL) (£28.486m), a breakeven position against non-core RRL (£0.144m), an underspend of £0.074m against capital resource limit and achievement of its cash requirement (£28.511m)	A balanced budget for 2018/19 was approved in March 2018. This included £0.6m of recurring and £1.38m of non-recurring savings that need to be achieved. This is in line with historic results and is split: <ul style="list-style-type: none">• £0.680m pay turnover• £0.700m general pay savings• £0.600 variable cost targets	HIS achieved £1.988m of savings during 2017/18 , of which £0.635m is recurring and £1.353m is non-recurring. The recurring savings relate to workforce savings, £0.390m, and support services, £0.245m.	The financial plan for 2018-19 estimates a funding gap of £0.739 million for the period 2018/19-2020/21.
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Governance statement

We have reviewed the draft annual governance statement. The disclosures are appropriate and address the minimum requirements of the Scottish Public Finance Manual (SPFM). There is, however, scope to reduce the level of detail disclosed, in accordance with the series of best practice notes published by Audit Scotland, to ensure the main messages are not lost. For example, rather than disclosing all members interests (covering 3 pages), this could be reduced to a few sentences, with a reference to where this is publicly available on the HIS website.

Pat Kenny
Audit Director

Our audit explained

Area dimensions

In accordance with the 2016 Code of Audit Practice, we have restricted our wider scope audit work to reviewing:

- The governance statement
- Financial sustainability

Significant risks

Our risk assessment process is a continuous cycle throughout the year. Page 8 provides a summary of our risk assessment of your significant risks.

Quality and Independence

We confirm we are independent of Healthcare Improvement Scotland. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Final audit report

In this report we have concluded on the audit risks identified in our planning report and any other key findings from the audit.

Key developments in your business

As noted in our planning report, HIS continues to face significant financial challenges due to an increase in costs whilst facing increased demand for services. This includes the continued regulation of Independent Healthcare and ensuring adequate capacity to contribute to the National Boards delivery plan.

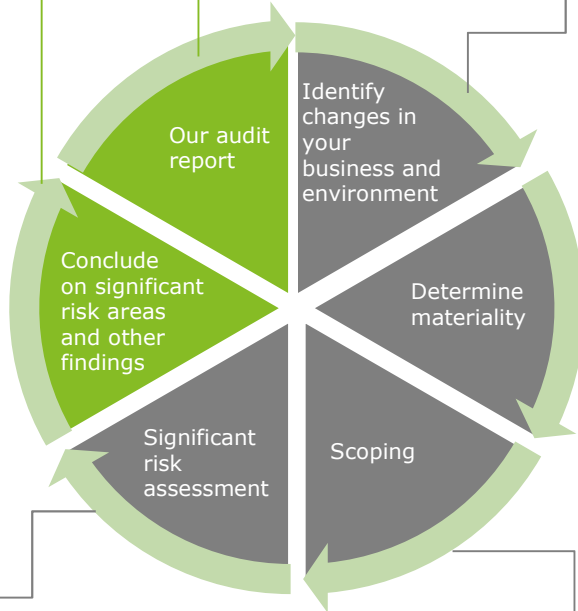
Materiality

The materiality of £585k and performance materiality of £439k has been based on the benchmark of gross expenditure and is a slight decrease from what we reported in our planning paper due to updated final figures.

We have used these as the basis for our scoping exercise and initial risk assessment. We have reported to you all uncorrected misstatements greater than £29k.

Scope of the audit

We have audited the financial statements of Healthcare Improvement Scotland for the year ended 31 March 2018.



Timeline 2017/18

November 2017

– Meetings with management and other staff to update understanding of the processes and controls.

6 December 2017

Presented planning paper to the Audit and Risk Committee

May 2018

Review of draft accounts, testing of significant risks and performance of substantive testing of results.

March 2018

Year end

16 May 2018

Audit close meeting

8 June 2018

Audit and Risk Committee workshop

21 June 2018

Audit and Risk Committee meeting










27 June 2018

Accounts sign off

Financial statements audit



Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Comments	Slide no.
Achievement of expenditure resource limit			D+I	Satisfactory		Satisfactory	9
Management override of controls			D+I	Satisfactory		Satisfactory	10
Revenue recognition – completeness of income from independent clinics			D+I	Satisfactory		Satisfactory	11

Overly prudent, likely to lead to future credit



Overly optimistic, likely to lead to future debit.

D+I: Testing of the design and implementation of key controls

Significant risks (continued)

Risk 1 – Achievement of expenditure resource limits

Risk identified

There is a key financial duty for Healthcare Improvement Scotland to comply with the Revenue Resource Limit set by the Scottish Government.

The risk is therefore that Healthcare Improvement Scotland materially misstates expenditure in relation to year end transactions, in an attempt to align with its tolerance target or achieve a breakeven position. The significant risk is therefore pinpointed to accruals made by management at the year end and invoices processed around the year end as this is the area where there is scope to manipulate the final results.



Key judgements and our challenge of them

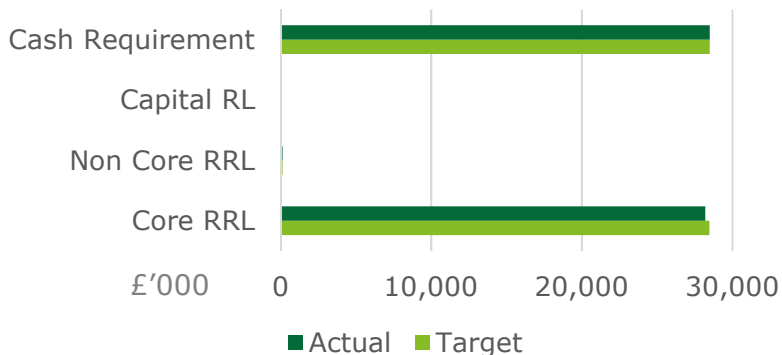
Given the financial pressures across the whole of the public sector, there is an inherent fraud risk associated with the recording of accruals around year end.



Deloitte response

We have evaluated the results of our audit testing in the context of the achievement of the target set by the Scottish Government. Our work in this area included the following:

- evaluated the design and implementation of the controls management has in place to monitor achievement of financial targets;
- obtained independent confirmation of the resource limits allocated to Healthcare Improvement Scotland by the Scottish Government;
- performed focused testing of accruals made at the year end; and
- performed focused cut-off testing of invoices received and paid around the year end.



Deloitte view

We have concluded through the performance of our year end procedures that the expenditure and receipts were incurred or applied in accordance with the applicable enactments and guidance issued by the Scottish Ministers and the expenditure is valid and correctly classified.

We confirm that Healthcare Improvement Scotland has performed within the limits set by the Scottish Government Health and Social Care Directorate (SGHSCD) and therefore is in compliance with the financial targets in the year.

Significant risks (continued)

Risk 2 - Management override of controls



Risk identified

In accordance with ISA 240, management override is a significant risk.

This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override HIS' controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risks around recognition of income and incurring of expenditure. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Deloitte view

We have not identified any significant bias in the key judgements made by management.

Deloitte response

We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- HIS' results throughout the year were projecting underspends in operational areas. This was closely monitored and whilst projecting underspends, the underlying reasons were well understood and regular discussions were held with Scottish Government; and
- Senior management's remuneration is not tied to particular financial results.

We have considered these factors and other potential sensitivities in evaluating the judgements made in the preparation of the financial statements.

Significant transactions

We did not identify any significant transactions outside the normal course of business or any transactions where the business rationale was not clear.

Journals

We have made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

We performed design and implementation testing of the controls in place for journal approval.

We have used Spotlight data analytics tools to test a sample of journals, based upon identification of items of potential audit interest. We did not identify any issues with journal postings from our testing.

Accounting estimates

In addition to our work on key accounting estimates discussed above, our retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements has been completed with no issues noted.

Significant risks (continued)

Risk 3 – Revenue Recognition

Risk identified

The risk of fraud in revenue recognition is a presumed risk under International Standards on Auditing. The main component of income for Healthcare Improvement Scotland is the revenue from the Scottish Government and this is not considered a significant risk as the process for receipt of this income is not complex and can be verified in its entirety.

In 2017/18, Healthcare Improvement Scotland recognised a material amount of other income from independent clinics (£0.6m), based on a statutory fee. The significant risk is pinpointed to cut-off and occurrence of this income.



Key judgements and our challenge of them

The key judgement for management to consider is the timing of receipt of income depending on status of registration.

£0.610m of income has been recognised in 2017/18 (2016/17: £0.324m).

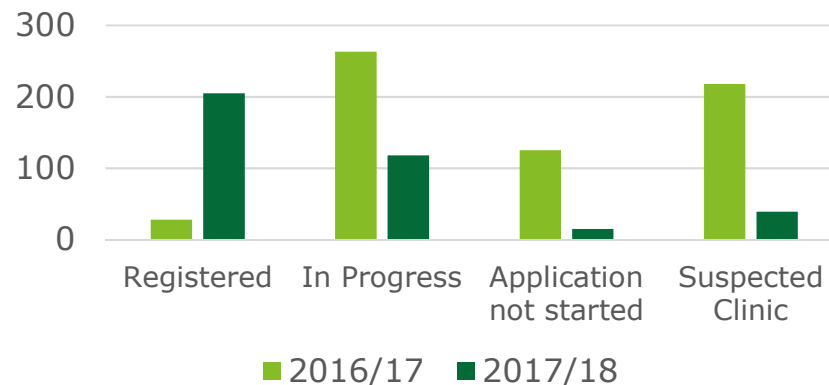


Deloitte response

Our work in this area included the following:

- Assessing management's controls around cut-off and occurrence of independent clinic income;
- Sample recalculation of independent clinics income to ensure cut-off of income at the year-end; and
- Sample testing of identified independent clinics or those suspected to be independent clinics, tracing to income recognised.

Number of Independent Clinics



Deloitte view

No issues have been identified with regards to the year-end controls around ensuring correct cut-off of income, and with the sample testing of independent clinics income.

Other significant findings (continued)

Insights delivered

We have utilised Spotlight to perform analytics on all of the journal entries processed during the year. We have highlighted some key themes arising from this work for your consideration.

Value Band (EC)	Number of Journals	% Number of Journals	Gross Value (EC)	% Gross Value (EC)
0	635	4.74%	0.00	0.00%
0.01 - 1	195	1.45%	173.82	0.00%
1.01 - 10	1,844	13.76%	23,193.93	0.01%
10.01 - 100	3,597	26.84%	443,167.74	0.23%
100.01 - 1,000	3,944	29.43%	3,014,728.58	1.59%
1,000.01 - 10,000	2,247	16.76%	27,860,692.37	14.66%
10,000.01 - 100,000	722	5.39%	39,922,750.58	21.00%
100,000.01 - 1,000,000	200	1.49%	79,112,799.83	41.62%
1,000,000.01 - 10,000,000	19	0.14%	39,722,225.57	20.90%

The journal posting efficiency at Healthcare Improvement Scotland is commendable: 23.78% of journals posted accounted for 98.18% of the total value posted in the year. This suggests that little time is wasted on accounting for miniscule amounts and that journals are efficiently posted in batch as required.

We identified the most commonly included words in journal descriptions posted to the general ledger. The prevalence of 'recode' and 'error' descriptions suggests a rate of journal posting error that could be considered for improvement, saving finance function time in correcting postings. We understand that all journals that have "unknown" descriptions are either system generated POP accruals for the GRNI or journals where the description has been copied from the original system generating the invoice processing and therefore have a clear business rationale and are appropriately authorised.

We performed a review of the posting frequency of staff with access to the system and noted that all staff have taken long holidays (>5 consecutive days) in the year, reducing concern for potential fraudulent behaviour or finance function stress and fatigue.



Our audit report

Other matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report. The revisions to ISA (UK) 700 have changed the form and content of audit report, including how different sections are presented.



Our opinion on the financial statements

Our opinion on the financial statements is unmodified.



Material uncertainty related to going concern

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting.



Emphasis of matter and other matter paragraphs

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



Other reporting responsibilities

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

Opinion on regularity

In our opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Our opinion on matters prescribed by the Auditor General for Scotland are discussed further on page 14.



Your annual report

We welcome this opportunity to set out for the Audit & Risk Committee our observations on the annual report. We are required to provide an opinion on the remuneration report, the annual governance statement and whether the management commentaries are consistent with the disclosures in the accounts.

	Requirement	Deloitte response
The Performance Report	The report outlines Healthcare Improvement Scotland's performance, both financial and non-financial, including achievements, issues and risks.	<p>We have assessed whether the performance report has been prepared in accordance with the accounts direction. No exceptions noted.</p> <p>We have also read the performance report and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p> <p>Whilst it is important for the annual report to clearly articulate the achievements and future plans (as discussed further on page 21), there is scope to reduce the level of detail disclosed to ensure the main messages are not lost. For example, the overview section could be reduced to set the scene and summarise issues, with the detail expanded within the analysis section. Currently the overview section is almost the same length as the analysis (6 pages v 7 pages). The use of infographics, charts and graphs could assist with this. Audit Scotland have issued a series of best practice guides which are discussed further on page 15 which we would recommend HIS consider for 2018/19 annual report.</p> <p>We also noted that the draft annual report was not available until towards the end of the audit site visit. We would recommend that a clear timetable is agreed for drafting annual report is to ensure it is aligned with the audit timetable.</p>
The Accountability Report	Management have ensured that the accountability report meets the requirements of the FReM, comprising the governance statement, remuneration and staff report and the parliamentary accountability report.	<p>As discussed further on page 18, we have assessed whether the information given in the governance statement is consistent with the financial statements and has been prepared in accordance with the accounts direction. No exceptions noted.</p> <p>We have also read the accountability report and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p> <p>We have also audited the auditable parts of the remuneration and staff report and confirmed that it has been prepared in accordance with the accounts direction.</p>
Going Concern	Management has made appropriate disclosure relating to Going Concern matters.	We have confirmed that the 2018/19 Local Delivery Plan was approved by the Board on 1 March 2018 and included draft budgets for 2018/19, 2019/20 and 2020/21. We have concluded that the plan is sufficiently robust to demonstrate that Healthcare Improvement Scotland will be a going concern for at least 12 months from signing the accounts. We note that confirmation was received that the Scottish Government are happy to sign off the plan.

Your annual report (continued)

Audit Scotland has issued a series of Good Practice notes to highlight where annual reports can be improved. We have provided below some extracts which should be considered by HIS in drafting future annual reports.

Length of performance reports

Boards need to strike a balance between completeness and conciseness in the level and type of information provided. There are risks that boards are either overly brief and do not fully meet the FReM's minimum requirements or they include too much unnecessary information leading to the main messages being lost.

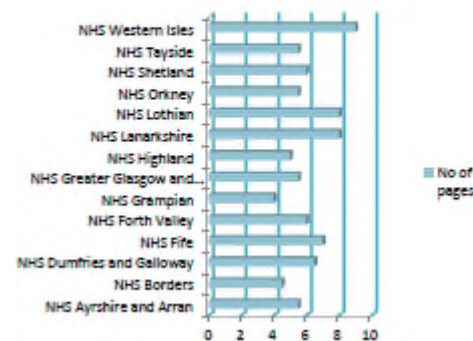
The HIS Performance and Accountability Report (excluding the Governance Statement and Remuneration Report) is 20 pages in 2017/18 so is much longer than the NHS territorial boards analysed in the chart, suggesting scope for reduction. While not directly comparable due to the unique nature of HIS, this does provide a useful benchmark.



Length of governance statement

Audit Scotland's good practice note in 2015 reported that there was more that could be done to improve the presentation of information and reduce clutter in governance statements. A review of the length of 2014/15 governance statements highlights the variation in the length of the disclosures.

Length of 2014/15 Governance statements



Board's need to strike a balance in the level and type of information provided. There is a risk that by providing too much information the significant risks are lost in the detail. The HIS Governance Statement is 17 pages long, therefore much longer than other NHS boards analysed in the chart, suggesting scope for reduction.

Key messages from good practice note issued in 2017.

Giving the reader enough information

- Ensuring balance between the overview and analysis sections
- Providing sufficient information
- Disclosure of PPP/PFI

Making clear disclosures

- Using overly technical information
- Clear explanation of financial performance
- Disclosure of brokerage

Telling a consistent story

- Providing a consistent narrative on the non financial indicators
- Making disclosures specific to the board
- Providing a high level balanced picture of performance

Wider scope audit work



Wider scope audit work

Overview

Public audit in Scotland is wider in scope than financial audit. This section of our report sets out our findings and conclusion on our audit work covering the following areas. As set out in our plan, due to the relative size and scale of the functions delivered by Healthcare Improvement Scotland, we concluded that the full wider scope audit was not appropriate. In accordance with paragraph 53 of the Code, our work in this area was restricted to concluding on:

- The appropriateness of the disclosures in the **governance statement**; and
- The **financial sustainability** of the Board and the services that it delivers over the medium to longer term.

Our report is structured in accordance with these two specific areas, but also covers our specific audit requirements on best value and specific risks as summarised below.

Best Value (BV)

The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

We have considered the accountable officers' duty to secure BV as part of the governance arrangements considered as part of the wider scope audit work.

Specific risks (SR)

As set out in our Annual Audit Plan, Audit Scotland had identified a number of significant risks faced by the public sector which we have considered as part of our work on the four audit dimensions.

- SR 1** – EU withdrawal
- SR 2** – New financial powers
- SR 3** – Ending public sector pay cap
- SR 4** – Cyber security risk
- SR 5** – Openness and transparency

Wider scope audit work (continued)

Governance statement

Audit dimension

As part of the annual audit of the financial statements, we have considered the appropriateness of the disclosures in the governance statement.

Areas considered



- The completeness of the disclosures in meeting the requirements of the essential features, as specified in the Scottish Public Finance Manual.
- Inconsistencies between the disclosures or between the disclosures and audit knowledge.

Deloitte response



Based on our audit work and the work of internal audit, we have not identified for reporting any changes in governance arrangements or any issues of concern in the governance statement.

As discussed further on pages 14 and 15, there is scope to reduce the level of detail disclosed to ensure the main messages are not lost. For example, rather than disclosing all members interests (covering 3 pages), this could be reduced to a few sentences, with a reference to where this is publicly available on the HIS website.

Deloitte view

The governance statement meets the requirements of the Scottish Public Finance Manual and no inconsistencies have been noted.

As discussed further on pages 14 and 15, there is scope to reduce the level of detail disclosed to ensure that the significant risks are not lost in the detail.

Having reviewed the processes in place at HIS – specifically with regards to treasury management and expenditure – and having identified no issues during our audit testing, we are satisfied that there are appropriate arrangements in place for securing best value.

Wider scope audit work (continued)

Financial sustainability

Audit dimension

As part of the annual audit of the financial statements, we have considered the appropriateness of the use of the going concern basis of accounting. Going concern is a relatively short-term concept looking forward 12 to 18 months from the end of the financial year. Financial sustainability interprets the requirements and looks forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Areas considered



- The financial planning systems in place across the shorter and longer terms.
- The arrangements to address any identified funding gaps.
- The affordability and effectiveness of funding and investment decisions made.
- Workforce planning.

Deloitte response



We have monitored HIS's actions in respect of its short, medium and longer term financial plans, including progress towards outcome based planning/ budgeting.

We have also monitored HIS's savings plans to assess whether the impact has been fully identified, mitigated and planned for.

Deloitte view

HIS continues to face a challenging financial position. HIS met all of its financial targets in 2017/18, however, the draft budget for 2018/19 is projecting £1.98m of savings that need to be achieved and has identified a funding gap of £0.739m over the period 2018/19 – 2020/21.

We note that as part of the additional pressures, HIS now also has to contribute to the Scottish Government Health and Social Care Delivery Plan. In 2017/18 the contributions to the Delivery Plan were £1.2m and in 2017/18 they have targeted £0.6m, which is part of the £1.98m savings.

Wider scope audit work (continued)

Financial sustainability (continued)

Short term financial position

For **2017/18**, the Board approved a balanced budget of £28.49m million (2016/17: £26.996 million), which included £0.63m recurring and £1.35m non-recurring savings (2016/17: £2.292 million). The final position for 2017/18 was an underspend of £0.27m.

The **2018/19** budget was approved by the Board in March 2018. This budgeted total expenditure of £28.99m incorporates £1.98m of savings. £0.400m of these savings have been classified as high risk.

In setting its budget, it has been recognised that a number of risks exist, such as demand and demographic changes. The most significant cost pressures identified were:

- Pay settlement assumption (1.00%) £0.185 m
- Incremental Drift £0.115 m
- Inflation assumption (2.50%) £0.240 m
- Increase in lease costs, Delta House £0.185 m

The budget includes pay awards which have been aligned to the thresholds set out by the Cabinet Secretary in the Stage 1 debate on 31 January 2018. It has been agreed by Scottish Government that any additional costs of the pay increase in excess of 1% will be met by central funding.

Medium to long term financial sustainability

HIS has achieved significant savings over the last 5 years, however due to increasing responsibilities and the continuing restraint in relation to funding settlements, it will have to consider how it can fundamentally transform service delivery in order to continue to meet its role.

In line with requirements for reporting to Scottish Government, HIS presents 3 year forecasts each year, which includes the forecast for the initial year discussed under 'Short term financial position'. While we did recommend in 2016/17 that longer term financial planning be developed for 5-10 years, we acknowledge that there is no such requirement as set by the Scottish Government and that it is difficult to anticipate the impact of such events as exit from the EU on future year's funding.

HIS has confirmed that as part of the National Board Collaboration, of which HIS is one of the eight boards, they are experimenting with 5 year plans.

HIS has refreshed their 5-year Corporate Strategy for 2017-22, *Making Care Better*. In addition to the 3-year financial plan being aligned to the Corporate Strategy, an aligned Workforce and Development Plan for 2017-20 has also been developed, recognising how integral the workforce is to the achievement of HIS' strategic priorities (note that staff costs made up 71.7% of gross expenditure in 2017/18).

As with all NHS bodies, HIS has challenging savings targets to meet moving forward to continue to be financially sustainable, which is under more pressure due to additional commitments to the National Board collaboration. HIS has made some progress in identifying areas of the organisation where it will realise these savings in 2018/19, however future years are more uncertain and detailed plans to realise these savings in each area should be agreed as soon as possible to ensure that HIS can achieve financial balance.

Wider scope audit work (continued)

Specific risks

In accordance with our Audit Plan, we have considered the specific risks identified by Audit Scotland as part of our audit as follows:

Risk identified	Response
<p>EU Withdrawal</p>	<p>The UK is expected to leave the European Union (EU) on 29 March 2019, followed by a transition period to the end of 2020. There are still a lot of uncertainties surrounding the terms of the withdrawal agreement but the outcome will inevitably have significant implications for devolved governments in Scotland and for Scottish public sector bodies.</p> <p>Given the scale of the potential implications and possible timescales for implementing changes, it is critical that public sector bodies are working to understand, assess and prepare for the impact on their organisation. This is likely to include consideration of three areas:</p> <p>Workforce: the extent to which potential changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.</p> <p>Funding: the extent to which potential changes to funding flows including amounts anticipated under existing EU funding programmes, are likely to affect the finances of the organisation and the activity that such funding supports.</p> <p>Regulation: the extent to which potential changes to regulation across a broad range of areas currently overseen at an EU level are likely to affect the activity of the organisation.</p> <p>HIS has noted that this is unlikely to have a significant impact on its operations but should keep a watching brief as the details are developed.</p>
<p>New financial powers</p>	<p>The Scottish Parliament's new financial and social security powers and responsibilities from the 2012 and 2016 Scotland Acts are fundamentally changing the Scottish public financials. The Scottish Government will publish its medium-term financial strategy in 2018 in response to recommendations in the Budget Process Review Group final report, and has made a number of other commitments to improve financial management and help Parliamentary scrutiny of decisions.</p> <p>As a result of this, there is an expectation that public bodies will be seen before subject committees of the Parliament more often. NHS Boards should therefore use this as an opportunity to make comment within their annual reports beyond the compliance requirements to clearly articulate their achievements against outcomes and future plans.</p>
<p>Ending public sector pay cap</p>	<p>As discussed on page 20, the 2018/19 budget includes pay awards which have been aligned to the thresholds set out by the Cabinet Secretary in the Stage 1 debate on 31 January 2018. It has been agreed by Scottish Government that any additional costs of the pay increase in excess of 1% will be met by central funding.</p>

Wider scope audit work (continued)

Specific risks (specific risks)

Risk identified	Response
<p>Cyber security risk</p>	<p>HIS has a structured approach to cyber security which follows the NHS Scotland Guideline as well as Scotland's cyber resilience strategy. The plan along with an implementation toolkit sets out 11 key actions that the Scottish Government, public bodies and key partners have requested to be done by the end of 2018 to further enhance cyber resilience in Scotland's public sector.</p> <p>HIS has setup a Cyber Security Working Group Team Meeting which meet every six weeks. This group is chaired by an executive lead and reports progress to the board and audit and risk committee. HIS also has a Business continuity plans in place which would be used in the event of any further cyber attack.</p> <p>HIS has a fully governed risk management system in place and has a Cyber security risk on the system. The risk tolerance is set by the level of the risk which is then discussed and reviewed by senior management. All operational and corporate risks are reviewed by the Audit and Risk committee quarterly and by the risk management working group monthly. The Audit and Risk committee receive a fully detailed update paper regarding the actions being taken by HIS to safeguard our systems and comply with Scottish Government cyber security legislation.</p>
<p>Openness and transparency</p>	<p>From our audit work, we are satisfied that HIS is appropriately open and transparent in its operations and decision making.</p> <p>A recent internal audit report considered the governance framework that operates within HIS and the work of the individual committees of the board. The report concluded that the annual report of the committee measured performance and remit and a satisfactory level of disclosure had been achieved. It was also suggested that the model used by HIS might be made available to other boards for their consideration.</p>

Technical update



Technical Update

New accounting standards for 2018/19 and 2019/20

IFRS 9, Financial instruments and **IFRS 15, Revenue from contracts with customers**, have been adopted for the 2018/19 Government Financial reporting manual (FRm). These new standards are not expected to have a significant impact on NHS Boards.

The effective date of **IFRS 16 Leases** is 1 January 2019, therefore will apply to NHS Boards from 2019/20, subject to both EU and HM Treasury adoption.

IFRS 16 removes the existing classifications of operating and finance leases under IAS 17 *Leases* for lessees.

It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing the lessee's obligation to make lease payments for the asset.

Healthcare Financial Management Association (HMFA) published its updated briefing in February 2018 on the application of IFRS 16. It notes that it is widely expected that the application of this standard will be time consuming for lessees so NHS bodies cannot postpone work until HM Treasury and then the Department of Health and Social Care (DHSC) produce their guidance. Therefore, the briefing sets out the practical steps NHS bodies should be taking now as well as highlighting the issues that will need to be considered when applying the standard for the first time.

Potential impact on Healthcare Improvement Scotland

Healthcare Improvement Scotland has significant operating lease commitments as at 31st March 2018 (£5.15m) which will be brought on to the statement of financial position from 2019/20 as both an asset and a corresponding liability. Given the material nature of the amounts and the expected time involved, it is recommended that management now consider the practical steps recommended in the briefing issued by HMFA.

Appendices



Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit and Risk Committee and the Board discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Our internal control observations
- Other insights we have identified from our audit

What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Board.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.

The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan and the supplementary "Briefing on audit matters" circulated separately.

This report has been prepared for the Audit and Risk Committee and the Board, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.



for and on behalf of Deloitte LLP
Glasgow

1 June 2018

Action plan

Recommendations for improvement

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Annual Report	<p>We noted that the HIS performance report and governance statement are much longer than the NHS territorial boards, suggesting scope for reduction. While not directly comparable due to the unique nature of HIS, this does provide a useful benchmark.</p> <p>We recommend that HIS review the good practice notes published by Audit Scotland and consider areas where disclosure could be reduced or presented in a different format to help ensure that key messages and risks are fully understood by the reader.</p>	<p>We are content with the length of the reports which we feel need to adequately explain the role and nature of HIS and to meet the needs of transparency. We will however review future statements in the light of good practice.</p>	Director of Finance & Corporate Services	31 March 2019	Medium
Annual Report	<p>We also noted that the draft annual report was not available until towards the end of our on site audit. We would recommend that a clear timetable is agreed for drafting annual report is to ensure that it is aligned to the audit timetable.</p>	<p>We agree that further steps could be taken in conjunction with External Audit to clarify at an early planning stage future audit timetable including deliverables which would benefit both parties</p>	Director of Finance & Corporate Services	31 January 2019	Medium

Action plan

Follow up of 2016/17 recommendations

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Financial Sustainability	<p>During this review in review of arrangements in relation to financial sustainability it was noted that the Local Delivery Plan (LDP) provided forecast budgets and expenditure covering up to financial year 2019/20 (medium term), in line with the LDP guidance, but there was no long-term financial planning in place.</p> <p>In line with best practice advocated by Audit Scotland, we recommend that the Board should introduce longer term financial planning.</p>	<p>Significant work has taken place to produce 3 year plans for finance, workforce and LDP. Scenario planning is incorporated within the finance plan to test variations in the financial assumptions and prove sustainability over this timeframe.</p> <p>Our judgement is that medium term financial planning (3 years) is appropriate considering the nature of organisation and our funding streams. Longer term financial planning is taking place in collaboration with other national boards and discussion has taken place around the potential impact of Brexit. These will all be reflected in future financial planning as soon as there is more certainty about their impact and will be overseen by the Audit & Risk Committee.</p>	Director of Finance & Corporate Services	Ongoing	Medium	HIS continues to create 3 year plans as per the Scottish Government guidance; however as part of the National Board Collaboration, HIS has been experimenting in the creation of 5 year plans. Due to the continuing aforementioned uncertainty regarding the possible impact in relation to Brexit it is not possible to take this forward at this time.

Action plan

Follow up of 2016/17 recommendations

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Financial Sustainability	<p>With regards to assessment of the effectiveness of investment spend, it was noted that reports are produced for all major projects and presented to the Board.</p> <p>Going forward Healthcare Improvement Scotland intend to set defined outcomes for the work undertaken and measure how major projects have contributed to improvements in key health outcomes.</p> <p>We would recommend that the Board progresses this initiative of linking major project spend to outcomes as quickly as possible and we will monitor progress on this during the period of our appointment.</p>	<p>During 2016-17 we developed an evaluation model using contribution analysis leading to the 9 health and wellbeing outcomes. We tested reporting of our work and its impact in contributing to these outcomes. This impact reporting is being refined as a priority during 2017-18 and is being overseen by the Quality Committee.</p>	Director of Finance & Corporate Services	Ongoing	Medium	<p>During 2017-18 the original evaluation model was amended and improved. All of HIS' work is now aligned to the 5 priorities as defined within the Making Care Better Strategy 2017-22. This includes the introduction of a 'Level one' performance report which measures work against activity and is reviewed by the Quality Committee with exception reporting being made to the Board from the Quality Committee; and a 'Level two' performance report that measures all key work against agreed outcome measures and is reviewed by the Board biannually. There is additionally a 'Level three' report which reports on specific case examples of how HIS are making a difference.</p>

Fraud responsibilities and representations

Responsibilities explained



Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.



Required representations:

We have asked the Board to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity.

We have also asked the Board to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



Audit work performed:

In our planning we identified the risk of fraud in complying with expenditure resource limits, completeness of independent clinic income and management override of controls as a key audit risk for your organisation.

During course of our audit, we have had discussions with management, internal audit and those charged with governance.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements

We have reviewed the paper prepared by management for the Audit and Risk Committee on the process for identifying, evaluating and managing the system of internal financial control.

Concerns:

No concerns have been identified regarding fraud.



Independence and fees

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	<p>The audit fee for 2017/18 is £26,819.</p> <p>No non-audit fees have been charged by Deloitte in the period.</p>
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	<p>We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.</p> <p>We are not aware of any relationships which are required to be disclosed.</p>



Events and publications

Our publications and insights to support the Board

Publications

The State of the State 2017-18

Citizens, government and business

This year's report finds the UK government amid the complex challenge of leaving the EU. Inevitably, this early phase of EU exit is taking place under intense media scrutiny and passionate political debate. But while EU exit issues may dominate headlines, the public services face more local challenges as they address rising demand, budget restraint and renewed levels of concern about social inequality.

The State of the State 2017-18 explores government through three lenses – the citizen lens, the public sector lens and the business lens.

Download a copy of our publication here:

<https://www2.deloitte.com/uk/en/pages/public-sector/articles/state-of-the-state.html>



Sharing our informed perspective

We believe we have a duty to share our perspectives and insights with our stakeholders and other interested parties including policymakers, business leaders, regulators and investors. These are informed through our daily engagement with companies large and small, across all industries and in the private and public sectors.

Recent publications relevant to the local authorities are shared opposite:

Perspectives: Do you have a digital mindset?

Accelerating health and care integration

Digital technology is helping to transform the way citizens interact with service providers across all other service industries. The time is now ripe for changing the relationship between health and social care commissioners and providers and service users.

Read the full blog here:

<https://www2.deloitte.com/uk/en/pages/public-sector/articles/do-you-have-a-digital-mindset.html>

Article: Public sector transformation **Five lessons from the private sector**

An analysis of private sector global companies, including high-tech start-ups, manufacturers, banks, retailers and insurance firms, reveal five valuable lessons for the public sector.

Read the full article here:

<https://www2.deloitte.com/uk/en/pages/public-sector/articles/public-sector-transformation.html>



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