



**NHS Ayrshire & Arran**

Planning report to the Audit Committee on the audit for the year ending  
31 March 2019

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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.

We have pleasure in presenting our draft planning report to the Audit Committee for the year ending 31 March 2019 audit. We would like to draw your attention to the key messages of this draft audit plan:

### **Audit Plan**

We have updated our understanding of the Board including discussion with management and review of relevant documentation from across the Board.

Based on these procedures, we have developed this plan in collaboration with the Board to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the Board.

### **Key Risks**

We have taken an initial view as to the significant audit risks the Board faces. These are presented as a summary dashboard on page 15.

- NHS Ayrshire & Arran continues to face significant financial challenges making it difficult to achieve financial balance. For the year to 31 March 2018, brokerage from the Scottish Government of £23m was required to reach a balanced position. This was highlighted in the Auditor General's report to the Parliament in October 2018. A deficit of £22.4m is projected for 2018/18 which will require additional brokerage from the Scottish Government.
- Key cost pressures for the Board which contributed to the need to seek brokerage

were: keeping hospital beds open to manage demand that was not budgeted for; unachieved cash releasing efficiency savings; and underlying financial pressures carried forward from 2016/17.

- As a result of these challenges, there is a significant audit risk that core expenditure limits are exceeded in the year, and a presumed fraud risk in accordance with auditing standards around the recognition of expenditure in the year. Our significant audit risk around achievement of expenditure resource limits is pinpointed to accruals and prepayments made at the year-end.
- In accordance with auditing standards, management override of controls has also been identified as a significant audit risk.
- Having considered the risk factors set out in Auditing Standards and the nature of the income streams at NHS Ayrshire & Arran, we have determined that the risk of fraud arising from revenue recognition can be rebutted. This is based on the fact that there is little incentive to manipulate income with the majority coming from Scottish Government which can be agreed to confirmations supplied.

# Introduction (continued)

## The key messages in this report (continued):

### Audit Dimensions

- The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how NHS Ayrshire & Arran is addressing these and report our conclusions in our annual report to the Audit Committee in June 2019. In particular, our work will focus on:
  - **Financial sustainability** – we will review the progress made in relation to the Transformational Change Improvement Plan (TCIP) following up on the recommendations made in our 2017/18 annual audit report. There is currently a risk that the plans are not substantial enough to achieve long term financial sustainability and that the Board does not have the supporting infrastructure required to deliver on the TCIP.
  - **Financial management** – From our audit work in 2017/18 we reported that the performance against budget in 2017/18 indicates a potential weakness in the budgeting and forecasting processes in place. We will follow up on how the budgeting process has been reviewed to ensure that it is sufficiently robust.
  - **Governance and transparency** – from our review of Board papers and attendance at Audit Committees we will assess the effectiveness of governance arrangements including the arrangements for securing effective clinical

governance and engagement and audit committee attendance. We will also review the governance arrangements in relation to the Integrated Joint Boards (IJB). As the IJBs pose significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the NHS Board and the IJBs (and the partner Councils) are not effective.

- **Value for money** – from our 2017/18 audit work we concluded that the Board had a well established performance management framework in place, with performance regularly considered by management and the Board. During 2018/19 we will review how the Board is addressing areas where targets are not being met. There is a risk that insufficient resources are targeted to areas of under performance and that the transformation change delivery infrastructure is not sufficiently designed to impact meaningful change in operations.

Our audit work on the four audit dimensions incorporates the specific risks highlighted by Audit Scotland, in particular, the impact of EU withdrawal, the changing landscape for public financial management, dependency on key suppliers and increased focus on openness and transparency.

# Introduction (continued)

## The key messages in this report (continued):

### **Regulatory Change**

New accounting standards on revenue and financial instruments will apply for 2018/19, and for leases from 2019/20. While we do not expect these standards to have a significant impact on NHS bodies, we recommend that the Board begin preparations for the implementation of these standards by conducting the following;

We would suggest that the Audit Committee receive reporting in year from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

We have reported on other regulatory changes in our sector updates in our separate report.

### **Our Commitment to Quality**

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

### **Adding value**

Our aim is to add value to the Board through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Board promote improved standards of governance, better management and decision making and more effective use of resources.

**Pat Kenny**  
Audit director

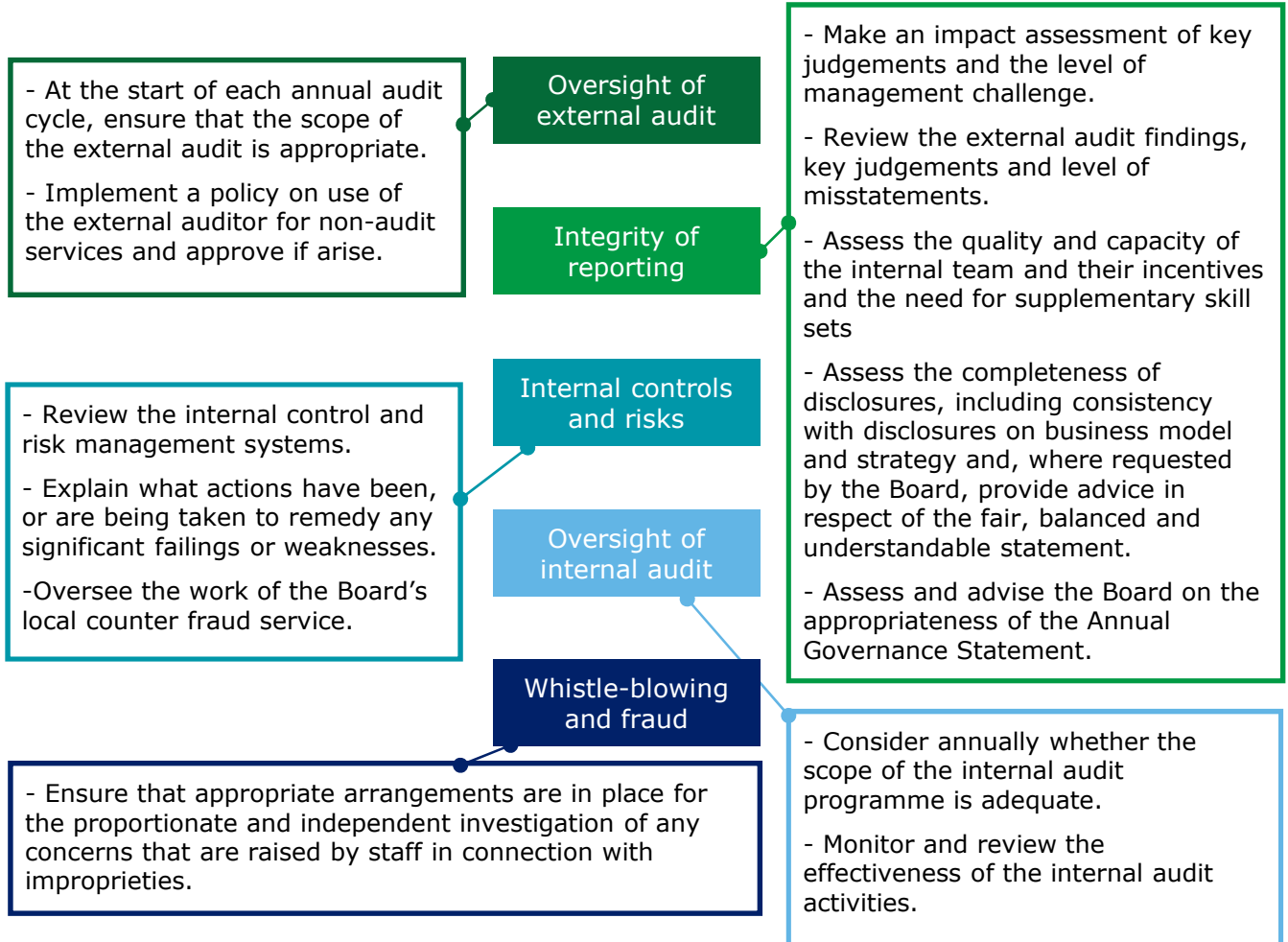
# Responsibilities of the Audit Committee

## Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Audit Committee:

- Clearly communicate the planned scope of the financial statements audit
- Provide timely observations arising from the audit that are significant and relevant to the Audit Committee's responsibility to oversee the financial reporting process
- In addition, we seek to provide the Audit Committee with additional information to help fulfil your broader responsibilities

As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.



# Our audit explained

## We tailor our audit to your Board and your strategy

### Identify changes in your Board and environment

The Board continues to face significant financial pressures due to an increase in costs whilst facing increased demand for services. This has resulted in the requirement of brokerage from the Scottish Government in the prior year (£23.0m) with a similar level of brokerage (£22.4m) forecasted in the year to 31 March 2019.

The integration of health and social care also continues to be a challenge, as discussed in page 10.

### Scoping

Our scope is in line with the Code of Audit Practice issued by the Audit Scotland.

More detail is given on pages 13 and 14.

### In our final report

In our final report to you we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report.



### Determine materiality

For the audit of NHS Ayrshire & Arran (Board only) a materiality figure of £15.7m (2017/18: £15.9m) has been determined, with performance materiality of £11.8m (2017/18: £11.9m). Materiality calculations have been based on forecasted gross expenditure in line with prior year.

Group materiality has been calculated as £15.7m (2017/18: £15.2m) with performance materiality of £11.8m (2017/18: £11.4m).

We will report to you any misstatements above £250k (2017/18: £250k) for both the Group and the Board only.

Any errors identified will be considered in the context of meeting the Revenue Resource Limit (RRL). More detail is given on page 12.

### Significant risk assessment

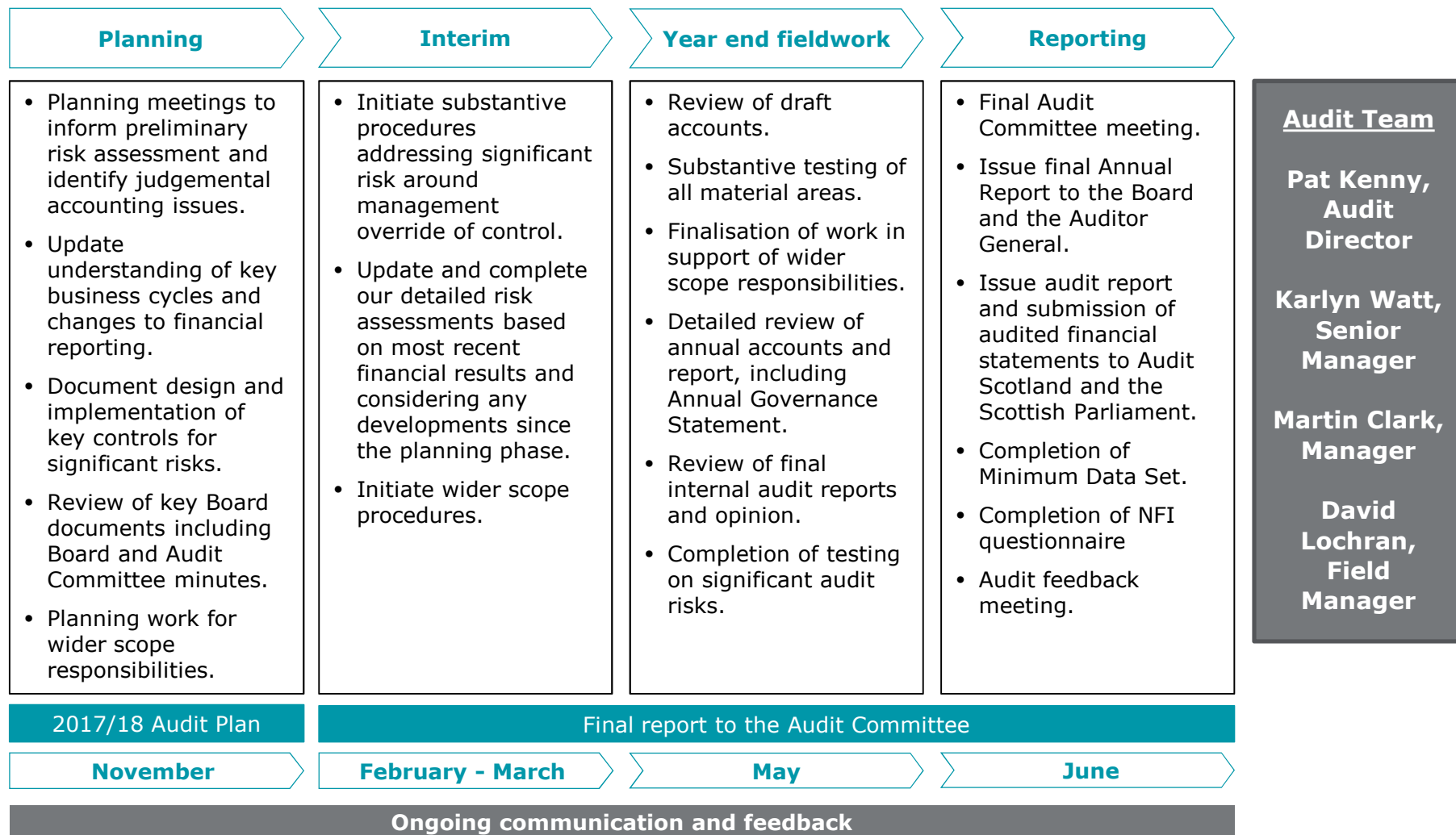
We have identified significant audit risks in relation to the Board. More detail is given on pages 15 to 17. These are consistent with our prior year audit.

### Quality and Independence

We confirm all Deloitte network firms are independent of NHS Ayrshire & Arran. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

# Continuous communication and reporting

## Planned timing of the audit





# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

Performance against expenditure resource limit



In 2017/18, significant cost factors such as agency costs and the use of un-funded beds meant that substantial brokerage (£23.0m) was required from the Scottish Government, without which a deficit of £22.8 would have been realised. We note that the projected position for 2018/19 shows an overspend of £22.4m indicating further brokerage will be required. As reported in our 2017/18 report, there is a clear strategy from the Board to focus on short term financial challenges that will impact on its financial performance but the Board should look to adopt a more medium-term approach to budgeting to gain a wider view of financial sustainability. We note that management have taken action to address this by performing detailed cost-benefit analyses of transformational programmes going forward.

There is an understanding throughout the Board that a balanced budget will only be achieved through real transformational change to service delivery in the medium to long term. This will be required to meet the increasing needs of an ageing population and the expectation that cost increases are expected to outpace funding increases. From our work in 2017/18, we concluded that the Board had not realised sufficient savings through the transformation programme, indicating that more work is required to achieve this goal.

Health and Social Care Integration



2017/18 was the third full financial year of Health and Social Care Integration between NHS Ayrshire & Arran and the three partnership Councils (North, East and South Ayrshire) through the Integration Joint Boards (IJB). Each partnership recognises that increasing demand, less funding and the need to make savings means that they must fundamentally change service delivery in order to operate effectively.

As reported in our 2017/18 annual audit report to the NHA Ayrshire & Arran Board, each of the Ayrshire IJBs have made significant progress to date but recognise that challenging areas remain. As is the case across Scotland, the Board along with the IJBs and Council partners should continue to work to resolve funding issues around shifting the balance of care between hospitals and communities.

We will continue to review the work being done both at the NHS Board and the IJBs to address these funding issues.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

# An audit tailored to you (continued)

## Focusing on your business and strategy (continued)

### Impact on our audit

Transformation Portfolio



An external review of the Board's Transformation Portfolio in 2016/17 detailed the steps taken by management to address forecasted budget deficits and increasing cost pressures, whilst also identifying key development points to be addressed by the Board as a matter of priority. It was highlighted that the Board faces significant short term financial challenges which are likely to worsen in the medium to long term unless focus moves away from short term interventions towards a longer term transformational strategy. One key finding raised in the review was that the current transformation plans in place were not substantial enough to achieve long term financial sustainability, and that plans for greater medium to long term transformational change are required.

Given the level of change required, we recommended in our 2017/18 report that the Board consider the supporting infrastructure required to deliver on the TCIP.

The Auditor General, in her October 2018 report, noted that implementing the recommendations will be challenging given the scale of the pressures in NHS Ayrshire & Arran. It is important that the Board puts in place a realistic action plan accompanied by the capacity and resources required to deliver it, in order to address the issues it faces, while also recognising that some of the changes will take time to fully implement.

We will be following up on the progress made with the TCIP as part of our 2018/19 audit.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

# Materiality

## Our approach to materiality

### Basis of our materiality benchmarks

- The audit director has determined materiality for NHS Ayrshire & Arran (Group) as £15.2m (2017/18: £15.9m) and performance materiality as £11.4m (2017/18: £11.4m). These have been displayed in the chart below.
- Board-only materiality has been calculated as £15.7m (2017/18: £15.9m) with performance materiality of £11.8m (2017/18: £11.9m). Group figures take into consideration the anticipated current year endowment fund expenditure as this impacts the overall gross expenditure.
- The above figures are based on professional judgement and risk factors specific to NHS Ayrshire & Arran, the requirement of auditing standards and the financial measures most relevant to users of the financial statements. We have used 1.8% of forecasted gross expenditure as the benchmark for determining materiality and applied 75% as performance materiality. This approach is consistent with our prior year materiality calculation.

### Reporting to those charged with governance

- We will report to you all misstatements found in excess of our clearly trivial threshold which is £250k (2017/18: £250k) for both the Group and Board only.
- We will report to you misstatements below this threshold if we consider them to be material by nature.

- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

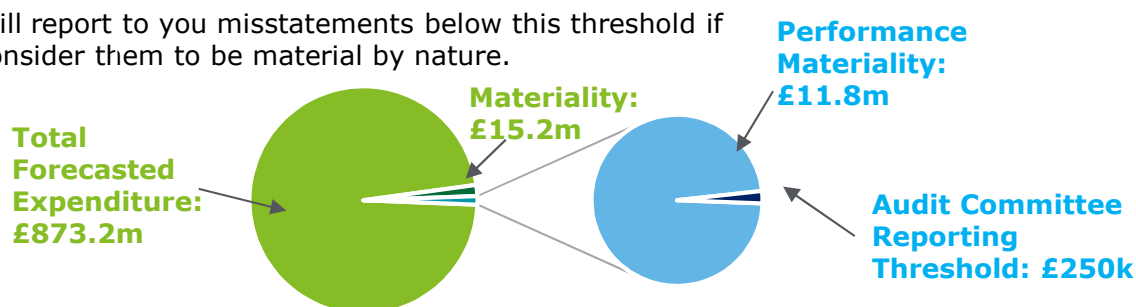
### Our annual audit report

We will:

- report the Group materiality, Board only materiality and the range we use for component materialities;
- provide comparative data and explain any changes in materiality, compared to prior year, if appropriate; and
- explain any normalised or adjusted benchmarks we use, if appropriate.

### Group scoping

The only significant component for the Group is NHS Ayrshire Arran. Full audit procedures will be performed on this component. As auditors of the three Integration Joint Boards, full audit procedures will also be performed on these components. The Endowment Fund will be covered by desktop reviews at the Group level.



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.



# Scope of work and approach

## Our key areas of responsibility under the Code of Audit Practice

Core audit work	Planned output	Timeline
Perform an ISA (UK) compliant audit of the annual accounts	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Interim report (if required)</li> <li>Independent auditor's report</li> </ul>	<ul style="list-style-type: none"> <li>November 2018</li> <li>March/April 2019</li> <li>June 2019</li> </ul>
Audit and report on the audit dimensions	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>November 2018</li> <li>June 2018</li> </ul>
Contribute to performance audits (including performance audit reports, overview reports and impact reports)	<ul style="list-style-type: none"> <li>Minimum datasets</li> <li>Data returns</li> </ul>	<ul style="list-style-type: none"> <li>June 2019</li> <li>As required</li> </ul>
Share intelligence with health and social care national agencies	<ul style="list-style-type: none"> <li>Intelligence template</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Share audit intelligence with Audit Scotland including highlighting potential statutory reports	<ul style="list-style-type: none"> <li>Current issues returns</li> </ul>	<ul style="list-style-type: none"> <li>January 2019</li> </ul>
Carry out preliminary enquiries into referred correspondence	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
Provide information on cases of money laundering	<ul style="list-style-type: none"> <li>Audit Scotland to advise</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Contribute to National Fraud Initiative (NFI) report	<ul style="list-style-type: none"> <li>NFI audit questionnaire. Reference, if necessary, in annual audit report.</li> </ul>	<ul style="list-style-type: none"> <li>June 2019</li> </ul>
Contribute to technical guidance notes	<ul style="list-style-type: none"> <li>Consultation comments on draft technical guidance notes</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>

# Scope of work and approach (continued)

## Our approach

### Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Board's staff.

### Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D&I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

### Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We have also designed and continually update International Financial Reporting Standards ("IFRS") disclosure checklists in conjunction with the requirements of the FReM to support the Board in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the Board complete during drafting.

We will continue to review an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management and the Audit Committee.

Audit Scotland has published good practice guides in relation the Annual Report and the Governance Statement to support the Board in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the Board consider during drafting.

Obtain an understanding of the Board and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

# Significant risks

## Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements; and
- the Board's actual and planned performance on financial and other governance metrics compared to its peers.

### Principal risks and uncertainties

- Lack of medical staff
- Failure to recruit to GP vacancies
- Primary care sustainability
- Inability to release efficiency savings

### IAS 1 Critical accounting estimates

- Clinical and Medical Negligence Claims
- Early Retirement

### Changes in your business and environment

- The brokerage requirements in the prior year (£23.0m) and anticipated brokerage in 2018/19 (£22.4m).
- Transformational changes to service delivery.

The next page summarises the significant risks that we will focus on during our audit. All the risks mentioned in the prior year Audit Committee report are included as significant risks in this year's audit plan.



# Significant risks (continued)

## Dashboard



Risk	Material	Fraud risk	Planned approach to controls testing	Level of management judgement	Page no.
Achievement of expenditure resource limits			Design and implementation		16
Management override of controls			Design and implementation		17



Some degree of management judgement



Limited management judgement

# Significant risks (continued)

## Risk 1 – Achievement of expenditure resource limits

### Key focus for management

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**Risk identified**

There is a key financial duty for NHS Ayrshire & Arran to comply with the Revenue Resource Limit set by the Scottish Government.

The Board has reported a cumulative overspend of £14.0m for the period up until 30 September 2018 and total overspend of £22.4m has been forecasted for 2018/19. There is therefore a clear likelihood that brokerage will again be required from Scottish Government to be paid back in future years.

There is a risk that the Board could materially misstate expenditure in relation to year end transactions, in an attempt to align with its tolerance target or achieve a breakeven position or reduce the level of brokerage required. The significant risk is therefore pinpointed to accruals and prepayments 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. Given the financial pressures across the whole of the public sector, there is an inherent fraud risk associated with the recording of accruals and prepayments around year end.

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**Planned audit challenge**

We will evaluate 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 will include the following:

- obtain independent confirmation of the resource limits allocated to NHS Ayrshire & Arran by the Scottish Government;
  - perform focused testing of accruals and prepayments made at the year end; and
  - performing focused cut-off testing of invoices received and paid around the year end.
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# Significant risks (continued)

## Risk 2 – Management override of controls

We will use computer assisted audit techniques, including Spotlight, to support our work on the risk of management override

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### **Risk identified**

In accordance with ISA 240 (UK) 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 the Board's controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risk around expenditure recognition. This is inherently the areas in which management has the potential to use their judgment to influence the financial statements.

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### **Planned audit challenge**

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

#### **Journal testing**

- We will test the design and implementation of controls over journal entry processing.
- Using our bespoke 'Spotlight' data analytics tool, we will risk assess journals and select items for detailed follow up testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest.
- We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting.

#### **Accounting estimates**

- We will test the design and implementation of controls over key accounting estimates and judgements.
- We will review accounting estimates for biases that could result in material misstatements due to fraud. This will include both a retrospective review of 31 March 2018 estimates and a review of the corresponding estimates as at 31 March 2019.

#### **Significant and unusual transactions**

- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

# Wider scope requirements

## Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how NHS Ayrshire & Arran is addressing these areas, including any risks to their achievement, as part of our audit work as follows which includes our assessment of the audit risks as required under paragraph 77 of the Code:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> <li>• The financial planning systems in place across the shorter and longer terms</li> <li>• The arrangements to address any identified funding gaps</li> <li>• The affordability and effectiveness of funding and investment decisions made</li> <li>• Workforce planning</li> </ul>	<p>The Board's TCIP is critical to delivering efficiency savings and to achieve financial balance over the medium term. As discussed on page 10, we will be following up on the progress made with the TCIP as part of our 2018/19 audit.</p> <p><b>Audit Risk:</b> There is a risk that the Board does not have realistic action plans, accompanied by the capacity and resources required to deliver it, in order to address the issues it faces.</p> <p>The Board is forecast an overspend of £22.4m in 2018/19 thus this level of brokerage is expected to be required. As part of our audit we will look to assess management's budgeting accuracy and plans to address identified funding gaps.</p> <p><b>Audit Risk:</b> There is a likelihood the Board will not be able to operate within its own financial means in the short to medium and further brokerage from Scottish Government will be required.</p> <p>In view of the Scottish Government's Medium Term Financial Strategy (MTFS) (discussed further on page 21) we will consider the extent to which the Board has reviewed the potential implications of the MTFS for its own financial and whether it is taking these into account in its arrangement for financial management and financial sustainability.</p> <p><b>Audit Risk:</b> The Board's long-term financial planning could be inconsistent with the Scottish Government's five-year plan.</p>

# Wider scope requirements

## Audit dimensions

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively</p>	<ul style="list-style-type: none"> <li>• Systems of internal control</li> <li>• Budgetary control system</li> <li>• Financial capacity and skills</li> <li>• Arrangements for the prevention and detection of fraud</li> </ul>	<p>In 2017/18 we highlighted weaknesses in the Board’s budgeting process as evidenced in the £23.0m brokerage being required from the Scottish Government.</p> <p>In view of the Scottish Government’s new budget process (discussed further on page 21) we will confirm that underling financial performance, including any in-year changes to funding agreed with the Scottish Government, is transparently presented.</p> <p><b>Audit Risk:</b> The board’s budgeting process is not accurate enough to determine spending forecasts and the underlying financial performance of the Board may not be transparently reported. We will look to assess these processes during the 2018/19 audit.</p> <p>Our fraud responsibilities and representations are detailed on pages 29 and 30.</p>
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> <li>• Governance arrangements</li> <li>• Scrutiny, challenge and transparency on decision making and financial and performance reports</li> <li>• Accountable officers’ duty to secure Best Value</li> <li>• Quality and timeliness of financial and performance reporting</li> </ul>	<p>We have found the Board’s governance framework and arrangements to be appropriate and supportive of effective governance and accountability. The relationship between Board members and management should continue to be open and transparent with effective challenge from Board meetings. We will monitor this as part of our audit work.</p> <p><b>Audit Risk:</b> There could be inefficient challenge of management from Board members leading to a lack of accountability within the Board.</p> <p>In view of the increased focus on how public money is used and what is achieved (as discussed further on page 21), we will consider how the Board has reviewed its approach to openness and transparency.</p> <p><b>Audit Risk:</b> The Board’s approach may not be keeping pace with public expectation and good practice.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> <li>• Value for money in the use of resources</li> <li>• Link between money spent and outputs and the outcomes delivered</li> <li>• Improvement of outcomes</li> <li>• Focus on and pace of improvement.</li> </ul>	<p>Performance in the last year had seen a decline with 50% of Local Delivery Plan (LPD) Performance Indicators falling within the 'red' category, meaning that they fell below acceptable standards. We will review the actions being taken by the Board, as part of the TCIP. The focus of transformational change cannot be solely on achieving financial efficiencies, but that the nature and extent of services must change fundamentally in order to improve standards of care in line with the national reporting standards and within the means of the annual budget.</p> <p><b>Audit Risk:</b> The Board may not make effective use of resources and fail to deliver transformational change to services.</p> <p>In view of the Scottish Government's new budget process (discussed further on page 21) we will consider the extent to which the Board performance report provides an accessible account of the Board's overall performance and impact of its public spending.</p> <p><b>Audit Risk:</b> The Board may not clearly report on its contribution towards the national outcomes. During our audit we will assess public spending and ensure this is in line with disclosure within the Board's performance report.</p>

# Wider scope requirements (continued)

## Specific risks

As part of the 2018/19 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. Any specific risks in relation to these areas for NHS Ayrshire & Arran have been included in our audit risk under the audit dimensions, discussed on the previous pages. We will continue to monitor these areas as part of our audit work.

Risk	
<b>EU withdrawal</b>	<p>There are uncertainties surrounding the terms of the UK's withdrawal from the European Union in March 2019. Some arrangements have been provisionally agreed, such as a transition period to the end of 2020, although they are dependent on a final deal being reached between the UK Government and the remaining EU countries. The outcome of negotiations should become clearer in the months up to March 2019.</p> <p>Whatever the outcome, EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. Audit Scotland has identified three areas where EU withdrawal may have the most significant impact as summarised below:</p> <ul style="list-style-type: none"><li>• <b>Workforce</b> – Many public services are dependent on workers from EU countries, including health, social care and education. A decline in migration from the EU could potentially result in vacancies and skills gaps in some areas of the public sector. There is a risk that this could impact on some public bodies' ability to deliver 'business as usual' particularly given existing workforce and service pressures.</li><li>• <b>Funding</b> – Funding from the EU makes an important contribution to the Scottish public sector. The main sources of funding provide support to farmers and rural businesses, projects to encourage economic growth and support for research and education. The UK Government has made guarantees to meet some funding commitments to the end of existing programmes, but there are uncertainties about what any replacement funding may look like.</li><li>• <b>Regulation</b> – The EU Withdrawal Bill will transpose existing EU law into UK law immediately after the UK leaves the EU. Legislation in many devolved areas will transfer to the Scottish Parliament. The UK government has identified 24 devolved policy areas where it seeks to retain temporary control until UK-wide common legislative frameworks are developed.</li></ul> <p>In addition, some public bodies may be affected directly by changes to trade and customs rules, which could impact on supply chains and the procurement of goods or services from EU countries. This could influence the availability and cost of supplies and services (e.g. specialist medical equipment or drugs) with potential implications for public bodies' finances and their ability to deliver specific services.</p> <p>While there are considerable uncertainties about the detailed implications of EU withdrawal, at a minimum, by the end of 2018/19, we would expect public bodies to have assessed the potential impact of EU withdrawal on their operations and identified any specific risks and how they will respond to them. We will assess how NHS Ayrshire &amp; Arran has prepared for EU withdrawal and how it continues to respond to any emerging risk after March 2019.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Changing landscape for public financial management</b>	<p>Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for 11 social security benefits worth over £3 billion a year. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater volatility, uncertainty and complexity.</p> <p>Parliamentary scrutiny of the public finances is increasingly important in this changing landscape. A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. This involves parliamentary committees looking back to explore what public spending has achieved, looking forward to longer-term objectives and challenges, and considering what this should mean for future budgets.</p> <p>As part of the new budget process, the Scottish Government published an initial five-year Medium Term Financial Strategy (MTFS) in May 2018. This five-year outlook for the Scottish budget provides useful context for audited bodies' financial planning. As part of our wider scope audit work on financial management and financial sustainability (discussed further on pages 18 and 19), we will consider how NHS Ayrshire &amp; Arran have reviewed the potential implications of the MTFS for its own finances, including longer-term financial planning.</p> <p>The new budget process places greater emphasis on assessing outcomes and the impact of spending. There is an expectation that the Scottish Government and public bodies will report on their contributions towards the national outcomes in their published plans and performance reports, including their annual reports. Increased complexity and volatility is also likely to mean that the Scottish Government will be increasingly active in managing its overall budget position in-year, engaging with public bodies closely on their anticipated funding requirements. As part of our wider scope audit work on financial sustainability and value for money (discussed further on pages 18-20) we will consider the extent to which NHS Ayrshire &amp; Arran's performance report provides an accessible account of the body's overall performance and impact of its public spending. We will also confirm that underlying financial performance, including any in-year changes to funding agreed with the Scottish Government, is transparently presented.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Dependency on key suppliers</b>	<p>It has become clear that the collapse of Carillion has had a significant impact across the public sector. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions. The risk exists on two levels:</p> <ul style="list-style-type: none"><li>• Individual public sector bodies are dependent on key suppliers; and</li><li>• The Scottish public sector as a whole is subject to significant systematic risk.</li></ul> <p>We will determine as part of our detailed risk assessment the extent to which NHS Ayrshire &amp; Arran is dependent on key supplier relationships. Where dependency is significant, we will consider this as part of our audit work and report back to the Audit Committee.</p> <p>We will also be requested to complete a short questionnaire to establish the extent, value and nature of key supplier dependencies that can inform the national position.</p>
<b>Openness and transparency</b>	<p>There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. We will consider this as part of our wider scope work on governance (discussed further on page 19).</p> <p>We would expect to see public bodies reviewing their approach to openness and transparency to ensure they are keeping pace with public expectations and good practice. Evidence of progress might include:</p> <ul style="list-style-type: none"><li>• increased public availability of Board papers</li><li>• more insight into why some business is conducted in private</li><li>• Development of the form and content of annual reports</li></ul>

# Wider scope requirements (continued)

## Other requirements

### Performance Audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits that Audit Scotland intends to publish during 2018/18 and 2019/20. There are no specific reports planned, other than the overview report, which directly impact on the NHS. We will provide an update to the Audit Committee if there are any changes to this plan.

### Impact reports

We will also be requested to provide information to support assessing the impact of previously published performance audit reports. There are no specific impact reports which directly relate to the NHS. We will provide an update to the Audit Committee if there are any changes to this plan.

### Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force on 26 June 2017 and replace the Money Laundering Regulation 2007. The regulations impose an obligation of the Auditor General to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist finance. As part of our audit work, we will ensure we are informed of any instances of money laundering at the Board so that we can advise the Auditor General.

### National Fraud Initiative (NFI)

All health Boards, except for the Mental Welfare Commission, are participating in the NFI 2018/1917. All data was required to be submitted in October 2018 and Boards will receive matches for investigation in January 2019. Audit Scotland expects bodies to investigate all recommended matches based on findings and the risk of error or fraud. Match investigation work should be largely completed by 30 September 2019 and the results recorded on the NFI system.

We will monitor the Board's participation and progress during 2018/19 and into 2019/20 and, where appropriate, include references to NFI in our annual audit reports for both years. We will also complete an NFI audit questionnaire and submit to Audit Scotland by 30 June 2019.



# Wider scope requirements (continued)

## Other requirements (continued)

### Sharing intelligence for health and social care

The Sharing Intelligence for Health and Care Group (SIHCG) is a mechanism that enables seven national agencies to share and consider intelligence about the quality of health and social care systems across Scotland. The Group was established in response to significant events in England relating to patient safety which highlighted key national organisations not adequately sharing intelligence on risks to inform their work. Similar arrangements are in place in other parts of the UK.

The agencies involved in the Group are:

- Audit Scotland
- Care Inspectorate
- Healthcare Improvement Scotland
- Mental Welfare Commission for Scotland
- NHS Education for Scotland
- NHS National Services Scotland
- Scottish Public Services Ombudsman

The overall aim of the Group is to support improvement in the quality of health and social care provided for the people of Scotland, by making good use of existing data, knowledge and intelligence.

Each health Board is covered by the Group once a year. We are required to complete an intelligence template and attend the Group meeting when the Board is considered to discuss the key points from our intelligence template submission. This also provides us with an opportunity to hear intelligence from the other agencies.

### Audit intelligence and statutory reports

The Auditor General determine whether a statutory report is required under section 22 of the Public Finance and Accountability (Scotland) Act 2000 for the Scottish Parliaments' Public Audit and Post Legislative Scrutiny Committee.

We are responsible for identifying and highlighting any significant issues arising which might prompt the Audit General to consider preparing a statutory report with issues arising during the year being raised timeously. We are required to provide Audit Scotland with returns summarising current issues. The Health sector return deadline is 21 January 2019. We will have early discussions with management of any issues arising.

# Audit Quality

## Our commitment to audit quality



Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

- We will apply professional scepticism on material issues and significant judgements identified, by using our expertise in the health sector and elsewhere to provide robust challenge to management.
- Over the two years of our audit relationship we have obtained and will continue to develop further a deep understanding of your business, its environment and of your processes in expenditure recognition, payroll expenditure and capital expenditure enabling us to develop a risk-focused approach tailored to NHS Ayrshire & Arran.
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve specialists to support the audit team in our work.

In order to deliver a quality audit to you, each member of the core audit team will receive tailored learning to develop their expertise in audit skills, delivered by Pat Kenny and other sector experts. This includes sector specific matters, and audit methodology updates.



### **Engagement Quality Control Review**

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

# 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 establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

### What we don't report

As you will be aware, our audit is 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, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

We will update you if there are any significant changes to the audit plan.

This report has been prepared for the Audit Committee, 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

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



**Pat Kenny, CPFA**

for and on behalf of Deloitte LLP

Glasgow

12 November 2018

# Appendices



# Prior year audit adjustments

## Uncorrected and disclosure misstatements

### **Prior year uncorrected misstatements.**

There were no uncorrected misstatements identified during the course of our prior year audit.

### **Prior year disclosure misstatements**

There were no uncorrected disclosure misstatements identified during the course of our prior year audit.

# Fraud responsibilities and representations

## Responsibilities explained



### Your 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.



### Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- 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.
- As set out in the significant risks section of this document, we have identified the risk of fraud in the achievement of expenditure resource limits and management override of controls as a key audit risk for your organisation.



### Fraud Characteristics:

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

### We will request the following to be stated in the representation letter signed on behalf of the Board:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud that affects the entity or Group and involves:
  - (i) management;
  - (ii) employees who have significant roles in internal control; or
  - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.



# Fraud responsibilities and representations (continued)

## Inquiries

We will make the following inquiries regarding fraud:



### **Management:**

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

### **Internal audit and Local Counter Fraud Specialist**

- Whether internal audit and the Board's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.



### **Those charged with governance**

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.





# 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:

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## Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Board and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2019 in our final report to the Audit Committee.

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## Fees

Fee range for the 2018/19 audit to be provided by Audit Scotland in early December 2018 will be discussed and agreed with management and the Audit Committee in early 2019.

There are no non-audit fees proposed for the period.

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## Non-audit services

In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Board'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.

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## Relationships

We have no other relationships with the Board, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

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# Our approach to quality

## AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

All the AQR public reports are available on its website. <https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

### The AQR's 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of Group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

#### The firm has enhanced its policies and procedures in the following areas:

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, Group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

#### Our key findings in the current year requiring action by the firm:

- Improve the Group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.



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