



NHS Shetland

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

Issued 20 November 2018 for the meeting on 29 November 2018

Contents

01 Planning report

Introduction	3
Responsibilities of the Audit Committee	6
Our audit explained	7
Continuous communication and reporting	8
An audit tailored to you	9
Materiality	11
Scope of work and approach	12
Significant risks	14
Wider scope requirements	18
Audit quality	26
Purpose of our report and responsibility statement	27

02 Appendices

Prior year audit adjustments	29
Fraud responsibilities and representations	30
Independence and fees	32
Our approach to quality	33

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 Shetland continues to face significant financial challenges. For the period up to 30 September 2018 an overspend of £1.9m was incurred, with a total overspend of £3.0m forecast for 2018/19.
- There are a number of factors contributing to this position, primarily overspends caused by GP locums (£1.5m) and unachieved efficiency savings (£1.3m). The Board has recognised that significant management action is required to be taken to ensure that it can achieve financial balance at the year end. Given the forecast overspend, management recognise there is a likelihood that brokerage from

Scottish Government may be required. NHS Shetland have yet to discuss this with the Scottish Government.

- 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 revenue streams at NHS Shetland, 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 revenue with the majority of income 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 Shetland 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 by the Transformational Change Board (TCB) following up on the recommendations made in our 2017/18 Annual Audit Report. There is currently a risk that the Board does not have the supporting infrastructure required to deliver transformational change and how this impacts on achieving financial targets.
 - **Financial management** – we will follow up on the recommendations made in our 2017/18 Annual Report in relation to the agreement of savings plans and linking financial plans to priorities. We will also review the budget monitoring reports to the Board during the year to assess whether financial management and budget setting is effective. Without robust financial management, there is a risk that the Board will not achieve its financial target.
 - **Governance and transparency** – our 2017/18 audit work concluded that there was scope to improve the governance arrangements between NHS Shetland and the Integration Joint Board

(IJB). As part of our audit work in 2018/19 we will review the governance arrangements to establish whether this recommendation has been implemented. Without effective governance arrangements, there is a risk that the partnership will not be able to achieve its objectives.

- **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.

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 review the impact of IFRS 9 and 15 early in the year, including calculating any adjustments that will be required as at 31 March 2018 for transition. 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

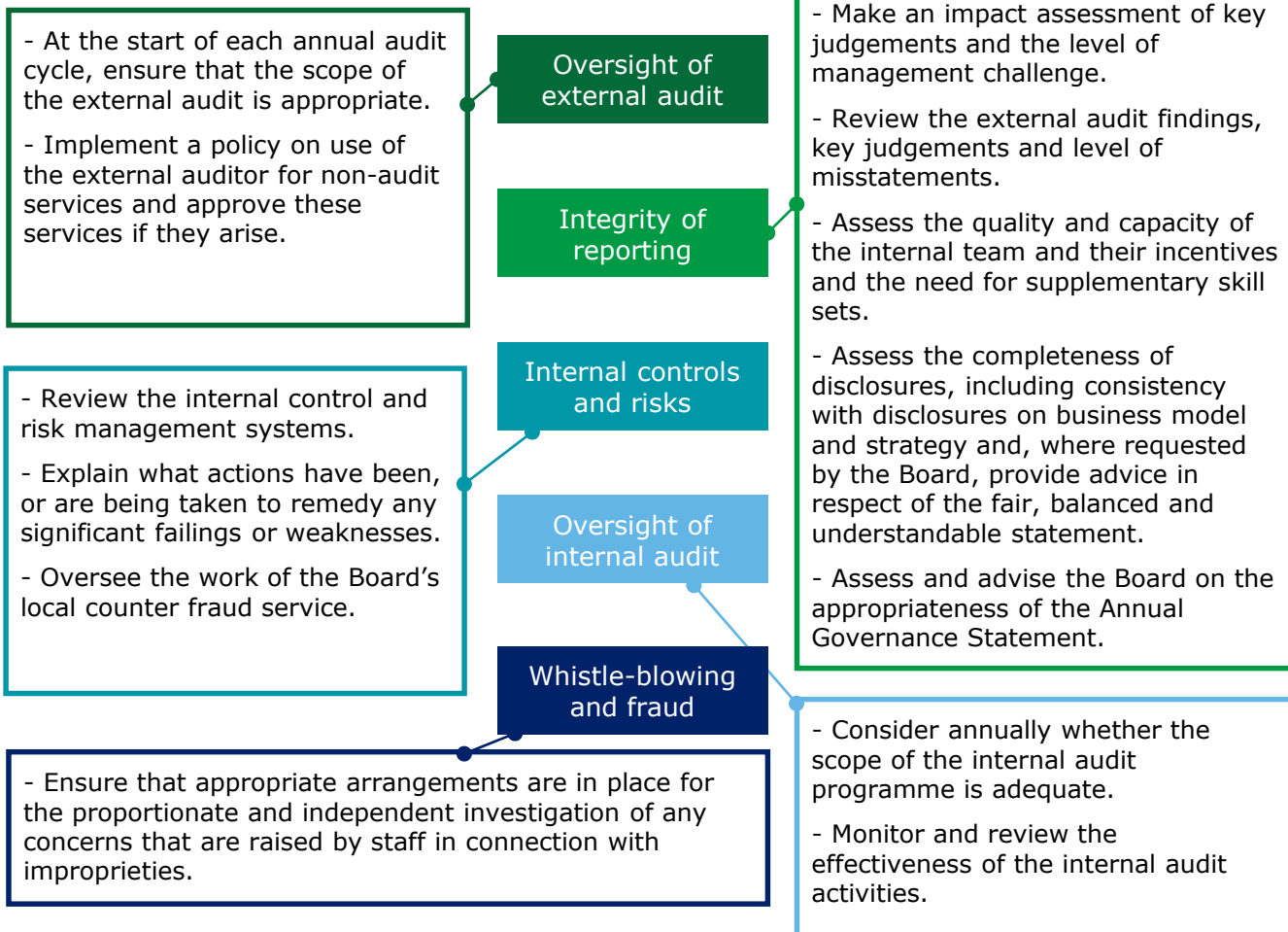
The primary purpose of the Auditor's interaction with the Audit Committee:

- 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.

We use this symbol throughout this document to highlight areas of our audit where the Audit Committee need to focus their attentions.



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 increased costs whilst facing increased demand for services. The Board are forecasting a £3.0m deficit for 2018/19 and may require brokerage to meet its Revenue Resource Limit (RRL).

The integration of health and social care also continues to be a challenge, as discussed on page 9.

A summary of these considerations is set out on page 9 and 10.

Scoping

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

More detail is given on pages 12 and 13.

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

We have determined a group materiality of £1,275k (2017/18: £1,246k) with a performance materiality of £956k (2017/18: £934k). This is based on forecast gross expenditure in line with prior year. For the audit of NHS Shetland (Board only) a materiality of £1,263k (2017/18: £1,224k) has been determined, with performance materiality of £947k (2017/18: £918k).

We will report to you any misstatements above £63k (2017/18: £62k) for both the group and the Board only.

Any errors identified will be considered in the context of meeting the RRL. More detail is given on page 11.

Significant risk assessment

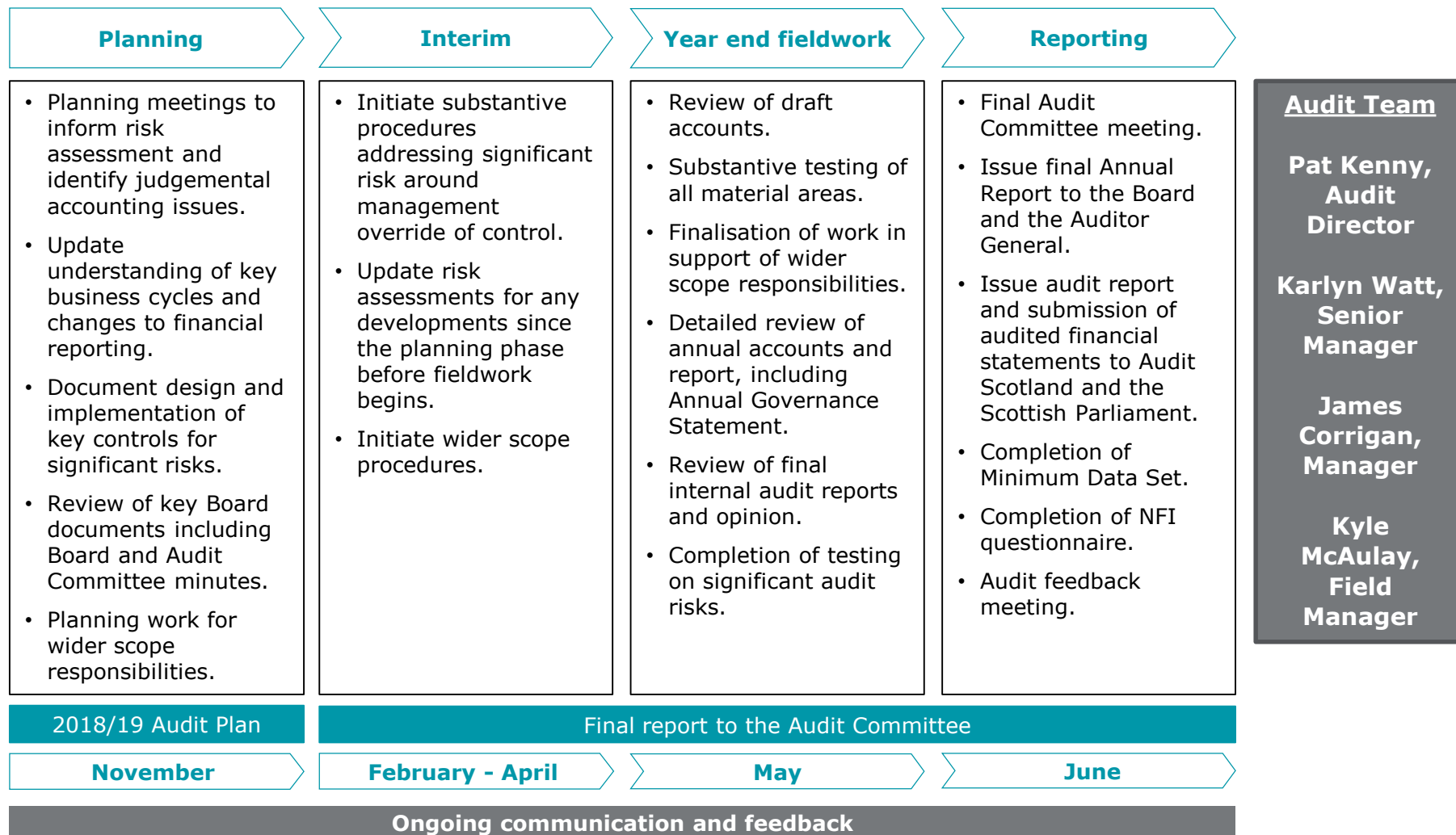
We have identified significant audit risks in relation to the Board. More detail is given on pages 15 to 17. These are consistent with our prior year audit.

Quality and Independence

We confirm all Deloitte network firms are independent of NHS Shetland. 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



There is a financial duty for NHS Shetland to comply with its Revenue Resource Limit (RRL), Capital Resource Limit (CRL) and cash requirements. As at September 2018 the Board is reporting an overspend of £1.9m against Core RRL, and is forecasting a £3.0m overspend for 2018/19. There is a risk that targets will not be met and brokerage will be required from the Scottish Government to enable a balanced budget to be achieved. We will evaluate the results of our audit testing in the context of the achievement of these targets. Our significant audit risk has been pinpointed to accruals and prepayments at the year end as these areas have a higher risk of management override as discussed further on page 16.

The Board must continue to look at how it can reduce costs to meet the challenge of making significant savings each year. As previously reported, the aim of achieving a breakeven position year-on-year for NHS Boards is becoming increasingly challenging and deters the Board's ability to look beyond the short term.

We will therefore review the progress of the work performed by the TCB and how this is driving the Boards plans to redesign services and achieve long term financial sustainability.

Health and Social Care Integration



2017/18 was only the second full financial year of Health and Social Care Integration between NHS Shetland and the Shetland Islands Council through the IJB. As reported in our 2017/18 Annual Audit Report to the IJB, the biggest risk it faces is the projected overspend in 2018/19 and the efficiencies required over the medium term to achieve a balanced budget. It is critical that the NHS Board works closely with the IJB and the Council to focus on implementing recurring savings through efficiencies or service redesign.

We will continue to review the work being done both at the NHS Board and the IJB 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

Transformational
Change Board



NHS Shetland is faced with particular challenges associated with the sustainability of services and recruitment and retention of its workforce. As a result of these challenges, a Transformational Change Board (TCB) was set up to help the Board identify efficiency savings and deliver service redesign. During 2017/18 a scenario planning exercise was carried out with the aim of quantifying demand pressures and resulting costs in a no change environment. This will be a key input in identifying the required level of transformational change. This was raised as a recommendation in our 2017/18 Annual Audit Report and as part of our 2018/19 audit, we will review the results of the scenario planning exercise and how this is being used to drive transformational change.

Given the level of change required, our 2017/18 report also recommended that the Board consider the supporting infrastructure required to deliver savings.

We will be following up on the progress made by the TCB 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 benchmark

The Audit Director has determined materiality for the group as £1,275k (2017/18: £1,246k) and performance materiality as £956k (2017/18: £934k).

For the audit of NHS Shetland (Board only) a materiality of £1,263k (2017/18: £1,224k) has been determined, and performance materiality of £947k (2017/18: £918k).

We have used 2.0% of forecast gross expenditure as the benchmark for determining materiality and applied 75% as performance materiality.

The above figures are based on professional judgement and risk factors specific to NHS Shetland, the requirement of auditing standards and the financial measures most relevant to users of the financial statements. 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 £63k (2017/18: £62k) 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.

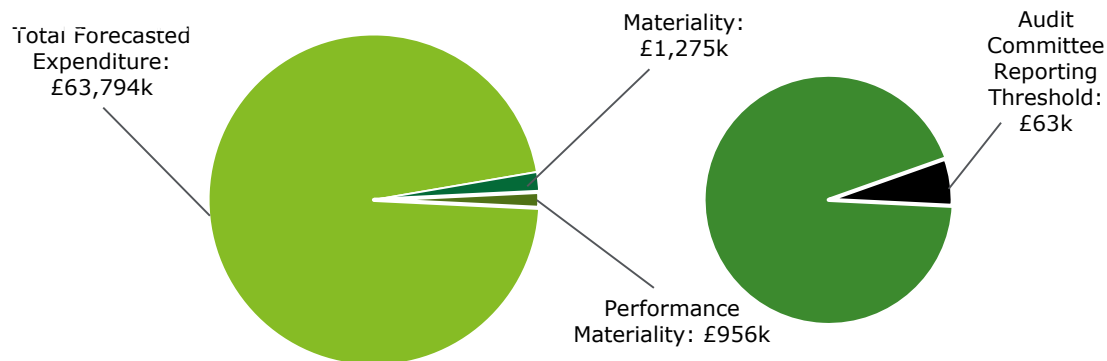
Our Annual Audit Report

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 significant components of the group are NHS Shetland and the IJB. Full audit procedures will be performed on NHS Shetland and as auditors of the IJB, full audit procedures will also be performed on this component.



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

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 to the Annual Report and the Governance Statement to support the Board in preparing high quality drafts of the Annual Report and Accounts, 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 D&I 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 Board's Corporate Risk Register;
- the IAS 1 critical accounting estimates previously reported in the Annual Report and Accounts;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last Annual Report and Accounts; and
- the Board's actual and planned performance on financial and other governance metrics compared to its peers.

Principal risk and uncertainties

- Financial management and efficiency savings
- Sustainable medical workforce
- Board performance against key non-financial targets

IAS 1 Critical accounting estimates

- Medical negligence claims
- Early retirement
- Fixed asset valuations

Changes in your business and environment

- New Chair of the Board
- New Scottish Government benchmark to breakeven over a three year period

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



Significant risks 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

Risk identified

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

The Board has reported a cumulative overspend of £1.9m for the period to 30 September 2018 and is forecasting a £3.0m overspend for 2018/19. There is therefore a clear likelihood that brokerage may be required from Scottish Government to enable a balanced budget to be met.

The risk is 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. 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.

Our response

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 Shetland by the Scottish Government;
 - perform focussed testing of accruals and prepayments made at the year end; and
 - performing focussed cut-off testing of invoices received and paid around the year end.
-

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

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 judgement to influence the financial statements.

Our response

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 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 Shetland 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>Financial sustainability 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"> • 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. 	<p>NHS Shetland have a TCB in place who are tasked with helping to deliver efficiency savings, achieve financial balance and redesign services over the medium term. Given the complexity of the changes required, the TCB needs to consider its supporting infrastructure to deliver these changes. As discussed on page 10, we will be following up on the progress made by the TCB as part of our 2018/19 audit.</p> <p>Audit Risk: There is a risk that the plans for efficiency savings, achieving financial balance and service redesign are not robust to allow the benefits to be realised.</p> <p>In view of the Scottish Government’s Medium Term Financial Strategy (MTFS) (discussed further on page 22) we will consider the extent to which the Board has reviewed the potential implications of the MTFS for its own financial planning and whether it is taking these into account in its arrangement for financial management and financial sustainability.</p> <p>Audit Risk: The Board’s long-term financial planning is inconsistent with the Scottish Governments five-year plan.</p>
<p>Financial management 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"> • Systems of internal control • Budgetary control system • Financial capacity and skills • Arrangements for the prevention and detection of fraud. 	<p>As at September 2018 the Board is reporting an overspend of £1.9m against Core RRL, and are forecasting a £3.0m overspend for 2018/19. We will review the budget and monitoring reporting to the Board during the year to assess whether financial management and budget setting is effective.</p> <p>Audit Risk: A lack of appropriate financial management could result in the Board not achieving its financial targets and breakeven over the three year benchmark as set out by the Scottish Government.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p>Financial management (continued)</p>		<p>In view of the Scottish Government’s new budget process (discussed further on page 22) we will confirm that underlying financial performance including any in-year changes to funding agreed with the Scottish Government is transparently presented.</p> <p>Audit Risk: The underlying financial performance of the Board is not transparently reported.</p> <p>Our fraud responsibilities and representations are detailed on pages 30 and 31.</p>
<p>Governance and transparency 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"> • Governance arrangements • Scrutiny, challenge and transparency on decision making and financial and performance reports • Accountable officers’ duty to secure Best Value • Quality and timeliness of financial and performance reporting 	<p>The Board’s governance framework and arrangements, including decision making and scrutiny, are appropriate and support good governance and accountability. However, as part of our 2018/19 planning work we identified that there is scope for further improvement as not all committee papers are routinely made available on the Board’s website. This has been noted and will be considered further during our audit.</p> <p>Audit Risk: There is a risk that the unavailability of information to public and stakeholders leads to the Board not being sufficiently transparent.</p> <p>Our 2017/18 Annual Audit Report highlighted that the NHS, Council and IJB work effectively together, with evidence of improvements in service delivery. There is, however, scope for the governance arrangements between the NHS Board and the IJB to be improved to ensure that respective roles and responsibilities are clear. During 2018/19, we will review the governance arrangements in place to ensure that these have been further enhanced.</p> <p>Audit Risk: As the IJB is still relatively new and has significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the NHS Board and the IJB are not effective.</p> <p>In view of the increased focus on how public money is used and what is achieved (as discussed further on page 22), we will consider how the Board has reviewed its approach to openness and transparency.</p> <p>Audit Risk: The Board’s approach is not 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>Value for money is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> • Value for money in the use of resources • Link between money spent and outputs and the outcomes delivered • Improvement of outcomes • Focus on and pace of improvement. 	<p>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.</p> <p>During 2018/19 we will review how the Board is addressing areas where targets are not being met.</p> <p>Audit Risk: There is a risk that insufficient resources are targeted to areas of under performance.</p> <p>In view of the Scottish Government’s new budget process (discussed further on page 22) 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>Audit Risk: The Board’s does not clearly report on its contribution towards the national outcomes.</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 Shetland 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	
EU withdrawal	<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">• Workforce – 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.• Funding – 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.• Regulation – 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. This is currently an area of contention between the Scottish and UK Governments and is under consideration by the Supreme Court. <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 Shetland has prepared for EU withdrawal and how it continues to respond to any emerging risks after March 2019.</p>

Wider scope requirements (continued)

Specific risks (continued)

Risk	
Changing landscape for public financial management	<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 MTFS in May 2018. This five-year outlook for the Scottish budget provides useful context for audited bodies' financial planning. Alongside the publication of this, the Cabinet Secretary announced recently that NHS territorial boards will no longer be required to break even at the end of each financial year. Instead, they will be required to break even every three years. This should provide NHS boards and integration authorities with greater flexibility in planning and investing over the medium to longer term to achieve the aim of delivering more community based care. It also makes it even more important that NHS boards plan their finances over a medium to longer-term period. 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 Shetland 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.</p> <p>As part of our wider scope audit work on financial sustainability and value for money (discussed further on page 18 and 20) we will consider the extent to which NHS Shetland'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	
<p>Dependency on key suppliers</p>	<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"> • Individual public sector bodies are dependent on key suppliers; and • The Scottish public sector as a whole is subject to significant systematic risk. <p>We will determine as part of our detailed risk assessment the extent to which NHS Shetland 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>
<p>Openness and transparency</p>	<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 and transparency (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"> • Increased public availability of board papers; • More insight into why some business is conducted in private; and • Development of the form and content of Annual Reports.

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 2018/19 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 Regulations 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 financing. 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 2018/19. 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 the 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

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 determines 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 Auditor 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-focussed approach tailored to NHS Shetland.

Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge.

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

20 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

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 their 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:

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.

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 services fees proposed for the period.

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.

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.



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.



Deloitte LLP does not accept any liability for use of or reliance on the contents of this document by any person save by the intended recipient(s) to the extent agreed in a Deloitte LLP engagement contract.

If this document contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities).

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NWE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NWE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.