



## **South Ayrshire Integration Joint Board**

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

Issued 25 February 2019 for the meeting on 1 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 planning report to the Performance and Audit Committee of South Ayrshire Integration Board ('the IJB') 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 IJB including discussion with management and review of relevant documentation from across the IJB.

Based on these procedures, we have developed this plan in collaboration with the IJB 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 IJB.

### **Key Risks**

We have taken an initial view as to the significant audit risks the IJB faces. These are presented as a summary dashboard on page 14.

In accordance with auditing standards, we have identified a significant risk associated with income. This risk is pinpointed to the recognition of income from its funding partners, South Ayrshire Council (the Council) and NHS Ayrshire and Arran (the Health Board) which accounts for the vast majority of income received.

In accordance with auditing standards, management override of controls has also been identified as a significant audit risk.

### **Audit Dimensions**

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how the IJB is addressing these and report our conclusions in our interim report to the Performance and Audit Committee in June 2019 and annual report to the Performance and Audit Committee in September 2019. In particular, our work will focus on:

**Financial sustainability** – as with other public sector bodies, the IJB continues to face financial challenges due to uncertainty around future funding and increase in demand for services. While South Ayrshire IJB has achieved financial balance in the past, it is projecting an overspend of £3.3m in the current year. In addition, as noted in our 2017/18 annual report, the IJB has yet to develop a medium-term financial plan to quantify the future funding gap it faces. We will monitor the IJBs actions in respect of the overspends arising in the year as well as the work being done to develop a medium-term financial plan.

# Introduction (continued)

## The key messages in this report (continued)

### **Audit Dimensions (continued)**

**Financial management** – we will review the budget and monitoring reports to the IJB during the year and liaise with internal audit in relation to their work on the financial control environment to assess whether financial management and budget setting is effective.

**Governance and transparency** – Our 2017/18 annual report highlighted that the current governance and reporting arrangements for the Lead Partnership arrangements was not as clear as for those areas under the direct control of the IJB. Our 2017/18 report also recommended that increased training be provided to IJB members to ensure that they fully understood their roles and responsibilities. We will follow up these recommendations to assess progress in 2018/19.

**Value for money** – from our 2017/18 audit work we concluded that the IJB had a sound performance management framework in place, with performance regularly considered by management and the Board. Reporting was clearly linked to strategic objectives and national outcomes; however, improvements could be made as to how the IJB shows that spending was making a difference in these areas. We will follow up progress with this in 2018/19. In addition, we will review how the IJB is addressing areas where targets are not being met and also how the implementation of strategic change is impacting on how the IJB's performance is measured and reported. 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.

### **Regulatory Change**

New accounting standards on revenue and financial instruments will apply for 2018/19, and for leases from 2020/21. While we do not expect these standards to have a significant impact on IJB's, we recommend that the IJB review the impact of IFRS 9 early in the year, including calculating any adjustments that will be required as at 31 March 2018 for transition. We would suggest that the Integration Joint Board 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.

# Introduction (continued)

## The key messages in this report (continued)

### **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 IJB 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 IJB promote improved standards of governance, better management and decision making and more effective use of resources.

**Pat Kenny**  
Audit director

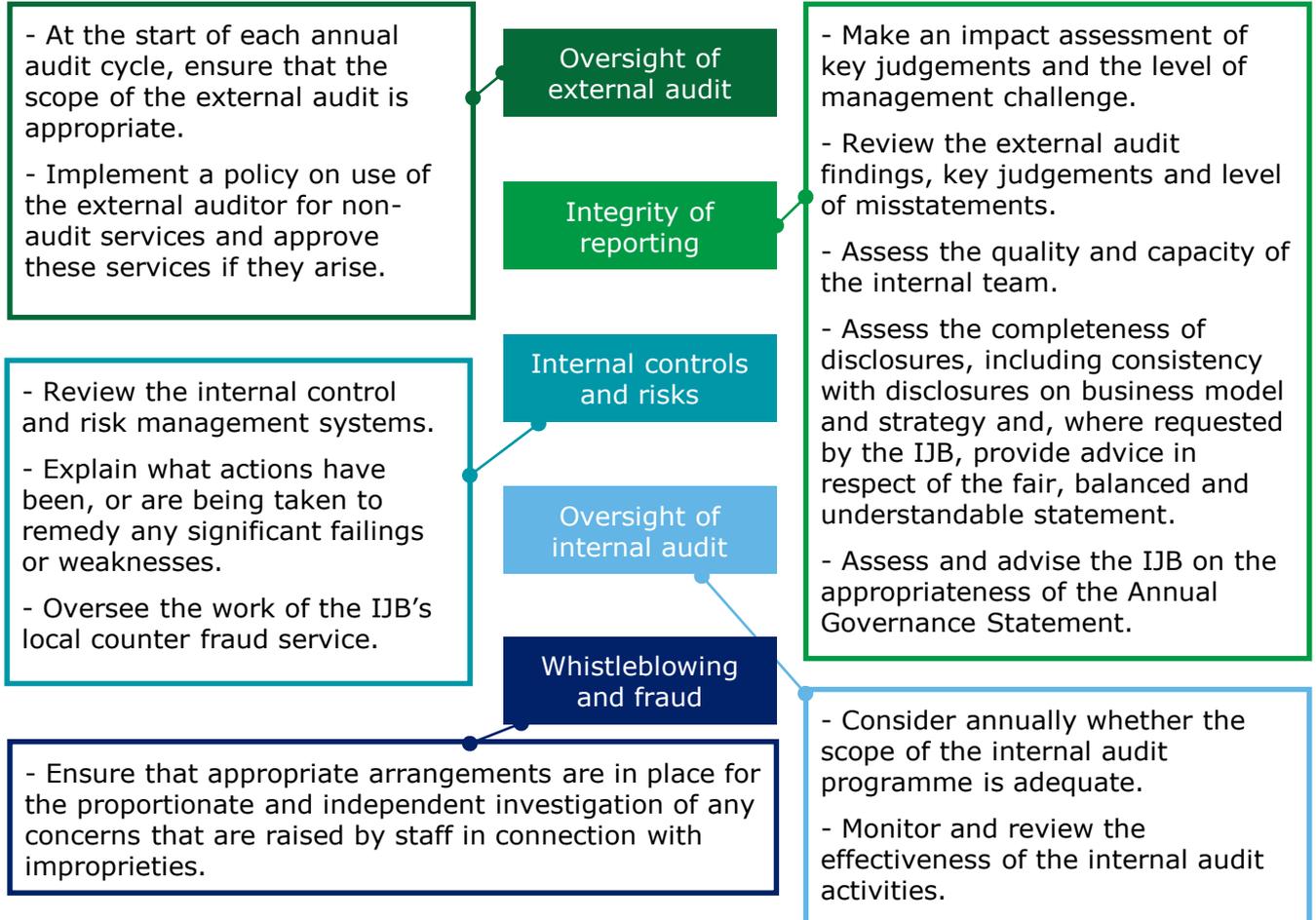
# Responsibilities of the Performance and Audit Committee

## Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Integration Joint Board:

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

As a result of regulatory change in recent years, the role of the Performance and Audit Committee has significantly expanded. We set out here a summary of the core areas of Performance and 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 Performance and Audit Committee in fulfilling its remit.

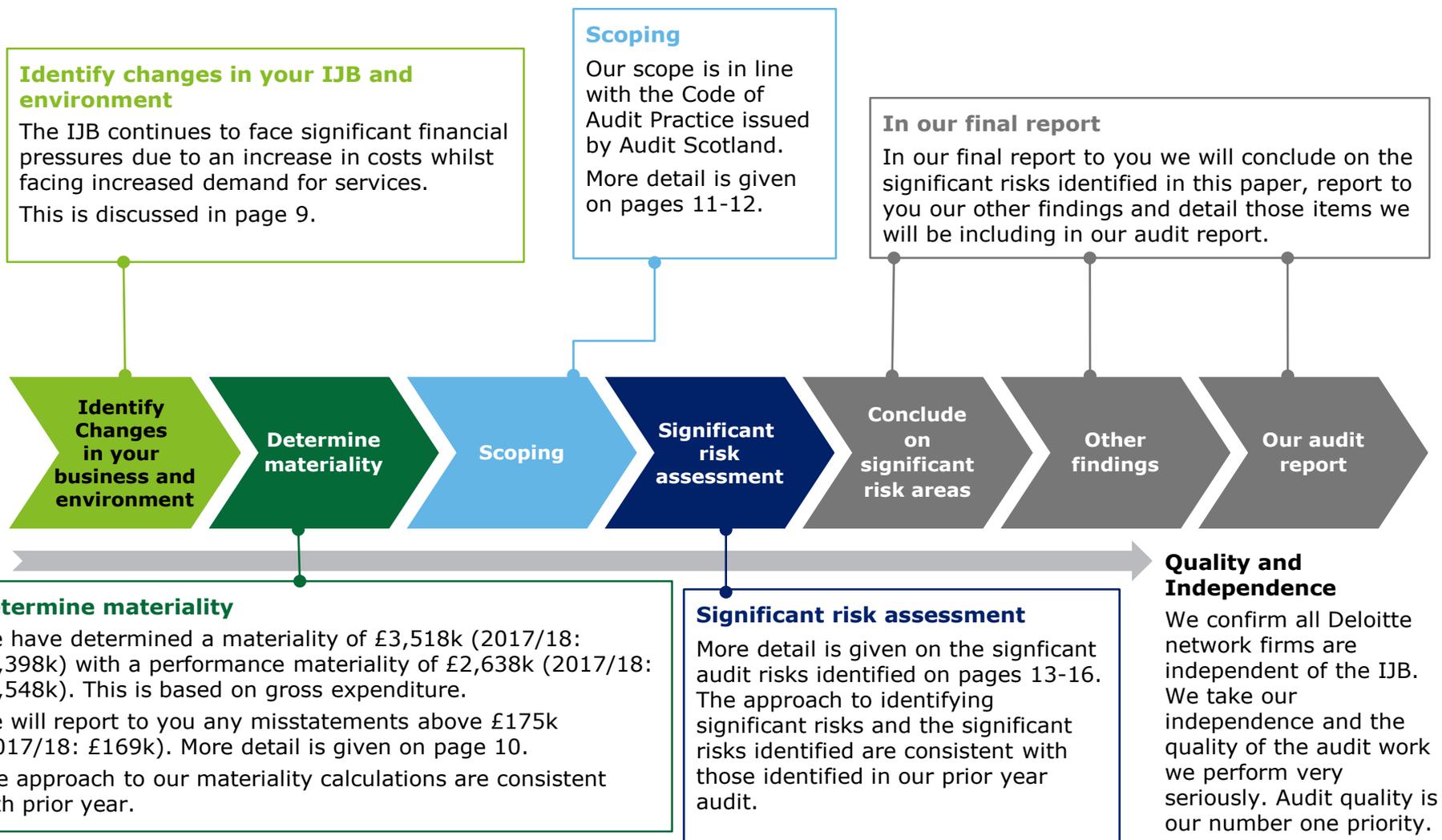


We use this symbol throughout this document to highlight areas of our audit where the Integration Joint Board need to focus their attentions.



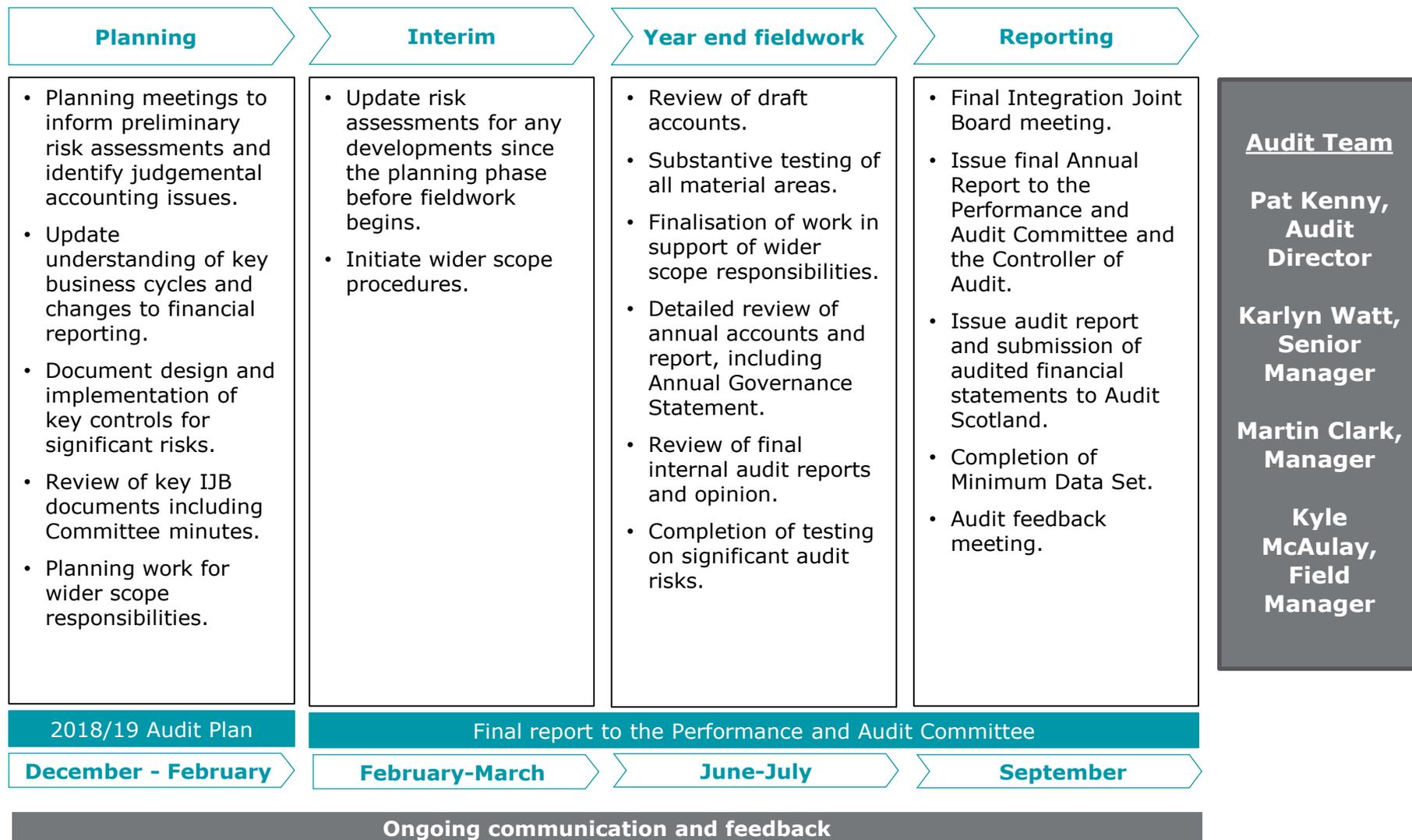
# Our audit explained

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



# Continuous communication and reporting

## Planned timing of the audit



# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

Future financial strategy and sustainability



South Ayrshire IJB has historically achieved short-term financial balance, however, as reported in our 2017/18 annual report, is faced with an extremely challenging financial position in the medium term. In 2018/19, the IJB is forecasting an overspend of £3.3m which assumes savings of £1.1m being delivered as a result of Recovery Plan actions which are not certain, therefore the final position could be higher. At its meeting in December 2018, the IJB considered a paper setting out the progress made to date in relation to the Budget Recovery Plan agreed in October and further proposals for in-year savings to balance the budget in 2018/19. The Board concluded that it could not accept the further savings proposals set out in the paper due to the potential negative impact of these on vulnerable service users and patients and requested a meeting with all parties to discuss the potential for additional interim funds being made available to the IJB. We understand that these discussions are ongoing and will follow up progress as part of our audit work.

We recommended in our 2017/18 report that a medium-term financial plan including sensitivity analysis and scenario planning was developed. We understand that this is being developed and will review the progress with this as part of our 2018/19 audit.

The IJB recognise that this is a significant financial risk of achieving a balanced position at a time of increasing demand for services. In addition, the lack of a confirmed funding position from NHS Ayrshire and Arran at the start of the financial year increases this risk. It is critical that the IJB has funding agreed early to ensure that it has sufficient lead in time to implement any changes required.



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 as £3,518k (2017/18: £3,398k) and a performance materiality of £2,814k (2017/18: £2,548k), based on professional judgement and risk factors specific to South Ayrshire IJB, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 1.6% of forecasted gross expenditure adjusted for net contributions to the IJB as the benchmark for determining materiality and applied 80% (2017/18: 75%) as performance materiality.
- This approach is consistent with our prior year materiality calculation. We have increased the percentage applied as performance materiality given the low history of error and the level of risk faced by the Board.

### Reporting to those charged with governance

- We will report to you all misstatements found in excess of our clearly trivial threshold which is £175k (2016/17: £169k).
- We will report to you misstatements below this threshold if we consider them to be material by nature.

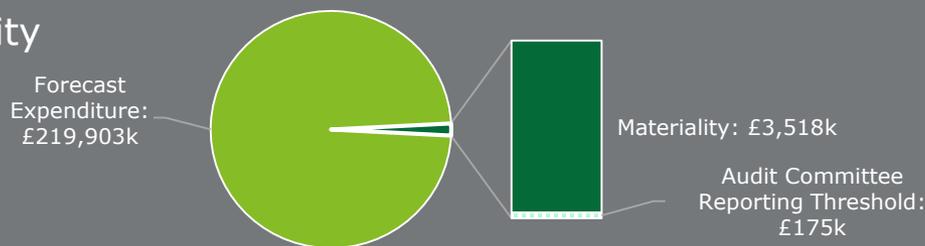
- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

### Our annual audit report

We will:

- Report the materiality benchmark applied in the audit of the IJB;
- 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.

### Materiality



Although materiality is the judgement of the Audit Director, the Performance and 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>Independent auditor's report</li> </ul>	<ul style="list-style-type: none"> <li>February 2019</li> <li>September 2019</li> </ul>
Audit and report on the audit dimensions	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Interim Report</li> <li>Annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>June 2019</li> <li>September 2019</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>September 2019</li> <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, March, August and October 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 fraud	<ul style="list-style-type: none"> <li>Fraud returns</li> </ul>	<ul style="list-style-type: none"> <li>November 2018, February, May and August 2019</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 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.

The IJB uses the corporate financial systems of the Council as well as the Council's internal audit function. 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 IJB, Council and Health 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 will utilise the Code of practice on local authority accounts in the UK disclosure checklist to support the IJB in preparing high quality drafts of the annual report and financial statements, which we would recommend the IJB complete during drafting.

The Disclosure Checklist reflects the cutting clutter agenda and includes a "not material" column. We would encourage the IJB to exclude disclosure if the information is not material.

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

Obtain an understanding of the IJB 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 as recorded in the partnership's risk register;
- 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 IJB's actual and planned performance on financial and other governance metrics compared to its peers.

### Principal risk and uncertainties

- Demographic Pressure
- Health Inequalities
- Unplanned Admissions
- Financial Constraints / Resource Allocations
- GP Availability
- Delayed Discharge

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



# Significant risks (continued)

## Dashboard

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
Completeness and accuracy of income			Design and implementation		15
Management override of controls			Design and implementation		16



Some degree of management judgement



Limited management judgement

# Significant risks (continued)

## Risk 1 – Completeness and accuracy of income

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**Risk identified** ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in income recognition, evaluate which types of income, income transactions or assertions give rise to such risks.

The main components of income for the IJB are contributions from its funding partners, namely South Ayrshire Council and NHS Ayrshire and Arran. The significant risk is pinpointed to the recognition of this income, being completeness and accuracy of contributions received from the Health Board and the Council. Given the year end deficit projected by the IJB, there is a risk that overspends could be funded by funding partners in the year following their approval, and therefore contributions could differ from the approved budget.

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**Planned audit response**

We will perform the following:

- test the income to ensure that the correct contributions have been input and received in accordance with that agreed as part of budget process and that any reductions have been appropriately applied;
  - test the reconciliations performed by the IJB at 31 March 2019 to confirm all income is correctly recorded in the ledger;
  - confirm that the reconciliations performed during 2018/19 have been reviewed on a regular basis; and
  - assess management's controls around recognition of income.
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# Significant risks (continued)

## Risk 2 – Management override of controls

We will use computer assisted audit techniques 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 IJB's controls for specific transactions.

The key judgements in the financial statements are those which we have selected to be the significant audit risks around completeness and accuracy of income. This is inherently the areas in which management has the potential to use their judgement 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.
- 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 out four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how the IJB in addressing these areas, including any risks to their achievement, as part of our audit work as follows:

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 IJB has achieved short-term financial balance in 2017/18 with an underspend of £968k. As noted on page 9, the 2018/19 forecast indicates that significant efficiencies need to be achieved to ensure financial balance due to a projected overspend of £3.3m in the current year.</p> <p>In our 2017/18 audit report, we noted that there was a lack of medium-term planning as well as a lack of a fully integrated budget. We understand that this is being developed and will review the progress with this as part of our 2018/19 audit.</p> <p><b>Audit Risk:</b> There is a risk that the IJB fails to take sufficient action to reach a financially sustainable position.</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 IJB 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><b>Audit Risk:</b> The IJB’s long-term financial planning is inconsistent with the Scottish Governments five-year plan.</p>
<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, including plans for replacing the recently departed Head of Finance.</li> <li>• Arrangements for the prevention and detection of fraud.</li> </ul>	<p>The IJB relies on the financial systems of both the Council and NHS and no material weaknesses have been identified from our work on the systems of either organisation. As noted above, there is a lack of integrated budgets and instead a separate NHS and Council budget is reported. We will assess the IJB’s process of budget monitoring and reporting as part of the 2018/19 audit.</p> <p><b>Audit Risk:</b> A lack of appropriate financial management could result in the IJB not achieving its financial targets.</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 underlying financial performance of the IJB is not transparently reported.</p> <p>Our fraud responsibilities and representations are detailed on pages 27 and 28.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<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>• Quality and timeliness of financial and performance reporting.</li> <li>• Accountable officers' duty to secure Best Value.</li> </ul>	<p>From our review of IJB papers and attendance at Performance and Audit Committees we will assess the effectiveness of governance arrangements. From our 2017/18 audit we reported that the governance and reporting arrangements for the Lead Partnership arrangement is not as clear as for those areas under the direct control of the IJB. We will follow up this issue in 2018/19 to assess whether any improvements have been made.</p> <p><b>Audit Risk:</b> There is a risk that governance arrangements between the IJB and its funding partners are not consistent.</p> <p>In view of the increased focus on how public money is used and what is achieved (as discussed further on page 20), we will consider how the IJB has reviewed its approach to openness and transparency.</p> <p><b>Audit Risk:</b> The IJB's approach is not keeping pace with public expectation and good practice.</p>
<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>We noted in our 2017/18 audit report that there is a clear framework in place to ensure that council performance is monitored and reported however improvements could be made in the means by which savings and efficiencies are reported by the IJB.</p> <p>As part of our procedures in 2018/19, we will assess the response to these recommendations and determine whether reporting will effectively show the savings made in specific areas.</p> <p>In view of the Scottish Government's new budget process (discussed further on page 20) we will consider the extent to which the IJB's performance report provides an accessible account of the IJB's overall performance and impact of its public spending.</p> <p><b>Audit Risk:</b> The IJB 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 South Ayrshire IJB 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 weeks 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 South Ayrshire IJB has prepared for EU withdrawal and how it continues to respond to any emerging risk after March 2019. Some suggested key questions for the Audit Committee are included in our separate Sector Update paper.</p> <p>In addition, in accordance with the FRC guidance, the IJB should consider the <b><u>disclosure within its annual report</u></b> and distinguish the specific and direct challenges that it faces from the broader economic uncertainties. In some circumstances this many mean <b><u>recognising or re-measuring</u></b> certain items in the Balance Sheet. A comprehensive <b><u>post balance sheet events review</u></b> may be required to be reflected in accounts and disclosures.</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 page 17), we will consider how South Ayrshire IJB has 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 page 17 and 18) we will consider the extent to which North Ayrshire IJB 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 South Ayrshire IJB 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 Integration Joint Board.</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 20).</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; and</li><li>• Development of the form and content of annual reports.</li></ul>

# Wider scope requirements (continued)

## Other responsibilities

### 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 IJB. We will provide an update to the Integration Joint Board 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 IJB. We will provide an update to the Integration Joint Board 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 he/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 IJB so that we can advise the Auditor General.

# 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 and local government sector and elsewhere to provide robust challenge to management.
- We have obtained a deep understanding of your business, its environment and of your processes in income recognition and financial reporting enabling us to develop a risk-focused approach tailored to the IJB.
- 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 where appropriate.

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 IJB.

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 Performance and 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

25 February 2019

# Appendices



# Prior year audit adjustments

## Misstatements and restatements

### Misstatements

During the 2017/18 audit there were no uncorrected misstatements above our clearly trivial threshold and no uncorrected disclosure deficiencies identified.

### Prior year restatement

Following a recent review of accounting policies across the wider sector, it was found that the IJB had carried forward £1,279k of reserves into 2017/18 from 2016/17 and recognised this as additional income within the 2017/18 Comprehensive Income and Expenditure Statement. Whilst it may be appropriate to recognise this as additional budget in the year for internal reporting purposes, it should not have been recorded as income in the year for external reporting purposes. As a result, income for the year was overstated by £1,279k.

It has been agreed with management that 2017/18 figures will be adjusted in the 2018/19 financial statements. See below for the appropriate adjustment required:

Dr Taxation and Non Specific Grant Income	£1,279k	
		£1,279
Cr Reserves Used in 2017/18		

It should be noted that the General Fund balance carried forward from 2017/18 is not impacted. This adjustment only changes the presentation of the use of reserves in the year.

# 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 recognition of grant income 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 IJB:**

- 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 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 IJB'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:

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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 IJB and will reconfirm our independence and objectivity to the Integration Joint Board for the year ending 31 March 2019 in our final report to the Integration Joint Board.

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**Fees** The audit fee for 2018/19, in line with the fee range provided by Audit Scotland, is £25,000 as analysed below:

	£
Auditor remuneration	17,200
Audit Scotland fixed charges:	
Pooled costs	1,670
Performance Audit and Best Value	5,050
Audit support costs	1,080
<b>Total proposed fee</b>	<b>25,000</b>

There are no non-audit services 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 IJB'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 IJB's, 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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