



NHS Highland

External Audit Plan for the financial year ending 31 March 2020

Final External Audit Plan to the Audit Committee

11 March 2020

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Our audit at a glance



Group planning materiality is set at **£8.86 million** (Board only: £8.84 million), being approximately 1% of gross expenditure based on 2019/20 budget (excludes IJB transactions). This is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements. We will apply a lower materiality threshold on review of the Remuneration and Staff report to ensure that remuneration has been disclosed within appropriate bandings (being **£2,500**). We will revisit our materiality throughout our audit including updating to reflect the unaudited financial statements.



NHS Highland is going through a period of significant transformation. Over the last 18 months, there have been changes in the senior management team, including a new Chief Executive as well as the appointment of an interim Chair of the Board. In addition, to support the Board address the financial challenges faced, the Scottish Government has provided specialist support to the Board, including the appointment of an interim Deputy Chief Executive. We will consider the governance arrangements in place at NHS Highland to ensure transformation activity is appropriately governed with oversight from the Board.



In accordance with Audit Scotland's planning guidance, during 2019/20 we review NHS Highland's **procurement arrangements**. In particular we will consider the arrangements in place to mitigate the risk of fraud and corruption in procurement.



Performance materiality is set at 75% of overall materiality. This is consistent with the prior year reflecting our audit knowledge and understanding with no material adjustments in the prior year.

An audit
underpinned by
quality



Significant audit risks are: management override of controls; the risk of fraud in revenue recognition; the risk of fraud in expenditure recognition as set out in Financial Reporting Council's (FRC) Practice Note 10; and, the valuation of land and buildings.



NHS Highland's underlying operating model is currently not financially sustainable without significant changes to service delivery. The Annual Operating Plan 2019/20 forecasts a funding gap of £39.4 million. Management has estimated that it can deliver £28 million of savings and will therefore require a further £11.4 million of brokerage funding to meet financial targets. We will focus on how the board is achieving its financial position in year, actual brokerage and how the savings realised and outturn is aligned to the Annual Operating Plan and medium term financial plan.



Our audit is undertaken in accordance with the Audit Scotland Code of Audit Practice and reflects the wider scope nature of public audit. Through our audit planning we have identified wider scope risks reflecting the boards **financial sustainability**, **financial management** and **governance arrangements**. This will include progress made by NHS Highland in implementing and embedding operational and cultural changes following the findings from the John Sturrock QC independent enquiry into bullying and corruption at the Board as well as following up the actions emerging from NHS Highland's Section 22 Report from the Auditor General for Scotland..

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Overarching principles of our audit

Our audit is risk based and undertaken in accordance with the International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016 ('the Code'). Our overall objective is a effective, quality-focused external audit which adds value through wider insights and challenge. Our audit foundations are:

- ✓ professional scepticism
- ✓ a focus on audit risks and key areas of management judgement
- ✓ Delivering a quality audit through our experienced public sector audit team, use of data analytics to focus our audit and understanding of the organisation
- ✓ clear and upfront communications, with regular communication during the year
- ✓ reporting with focused actions which will support you in improving your controls/operations

External Audit plan

The External Audit Plan summarises our responsibilities in accordance with Audit Scotland's planning guidance requirements:

- Respective responsibilities;
- Our audit process and timeline
- Materiality
- Our risk based audit approach to the audit of the financial statements and NHS Highland's Whole of Government Accounts (WGA) submission
- Our wider scope responsibilities including those in relation to the four wider audit dimensions prescribed in the code: Financial management; financial sustainability; governance and transparency; and, value for money.

Continuous improvement and adding value

Our aim is to add value to NHS Highland through our external audit work. This will be delivered through delivering a high-quality audit. Specifically for the board we will also undertake the following arrangements:

Continuous learning and development: We have discussed with NHS Highland's senior finance team to identify opportunities to develop our audit approach to ensure we deliver and efficient and effective audit. We have revised our approach for 2019/20, including bringing forward our planned audit procedures over wider scope areas to support more timely communication and reporting of our audit conclusions over these areas.

Robust and effective audit methodology: Our ISA compliant audit methodology is tailored to focus audit resource on significant risk areas and key estimates and judgements.

Constructive challenge and feedback: We aim to provide constructive challenge by identifying areas of improvement and by recommending and encouraging good practice.

Audit appointment

The Auditor General for Scotland is an independent Crown appointment, made on the recommendation of the Scottish Parliament. The Auditor General is independent and not subject to control of any member of the Scottish Government or the Parliament. The Auditor General is responsible for securing the audit of the Scottish Government and most public bodies, including NHS bodies in Scotland, and reporting on their financial health and performance.

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out her statutory functions, including monitoring the performance of auditors through a quality control process.

The Auditor General has appointed Grant Thornton UK LLP as external auditor of NHS Highland for the five year period 2016/17 to 2020/21.

Our team

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The audit will be supported by a team of qualified and part qualified accountants from our public sector audit team. Where required we will use other audit experts, including Public Sector technical accounting team to support our audit.

Respective responsibilities

As set out in the Code of Audit Practice there are a number of key responsibilities you as an organisation are responsible for, and others, as appointed auditors we are responsible for. These are summarised below:

| Area | NHS Highland's Responsibilities |
|----------------------|--|
| Corporate governance | <ul style="list-style-type: none"> Establishing arrangements for proper conduct of its affairs Legality of activities and transactions Monitoring adequacy and effectiveness of arrangements (inc role of those charged with governance) |
| Financial statements | <ul style="list-style-type: none"> Preparing financial statements which give a true and fair view of their financial position Maintaining accounting records and working papers Putting in place systems of Internal Control and maintaining proper accounting records Preparing and publishing an annual governance statement, management commentary and remuneration report Effective systems of internal control as well as financial, operational and compliance controls – supporting achievement of objectives and secure value for money |
| Financial position | <ul style="list-style-type: none"> Proper arrangements to ensure financial position is soundly based and responsibility to ensure arrangements secure Value for Money |
| Fraud and error | <ul style="list-style-type: none"> Establishing appropriate arrangements for prevention and detection of fraud, error, irregularities, bribery and corruption and affairs are properly managed |

Our responsibilities



- Undertake statutory duties and comply with professional engagement and ethical standards
- Provide an ISA compliant opinion on financial statements and where appropriate regularity of transactions
- Review and report on, as appropriate, other information eg annual governance statements, management commentary, remuneration reports
- Notify the Auditor General when circumstances indicate a statutory report may be required
- Demonstrate compliance with wider public audit scope in accordance with Audit Scotland's Code of Audit Practice and applicable guidance
- Contributing to Audit Scotland Performance Reports
- Providing regular updates to Audit Scotland to share awareness of current issues across our audit clients
- Notify Audit Scotland of any cases of money laundering or fraud
- Contribute to National Fraud Initiative (NFI) report
- Contribute to Audit Scotland technical guidance

How do we do this in practice

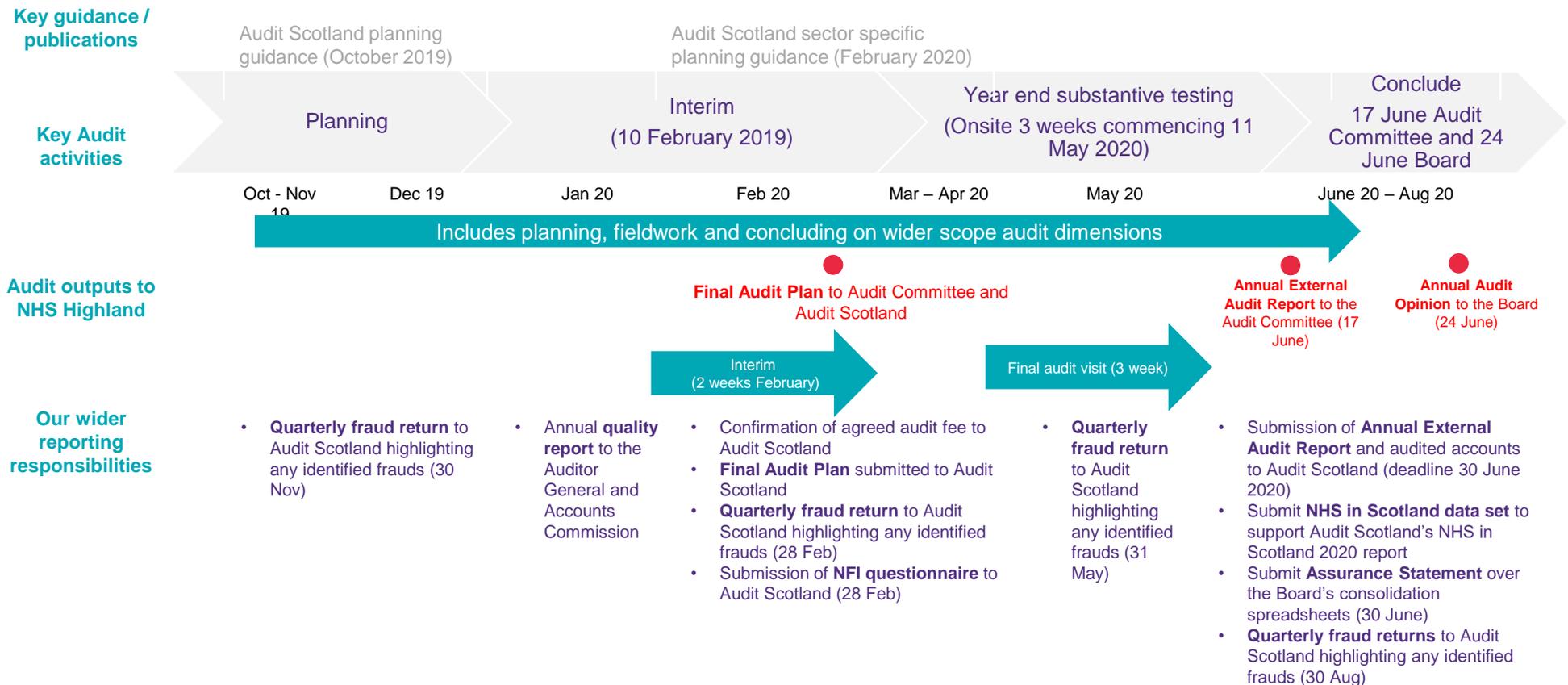


- By reviewing and providing judgements and conclusions on NHS Highland arrangements including those across the wider scope of audit dimensions.
- Suitability and effectiveness of corporate governance arrangements in year
- Financial position and arrangements for ensuring financial sustainability in the medium to longer term
- Review of other information in line with our knowledge and understanding of NHS Highland
- Ongoing dialogue and engagement with Audit Scotland during the year
- Providing quarterly fraud updates to Audit Scotland and information on any money laundering
- Providing relevant data to Audit Scotland relating to NHS Highland to contribute to shared risk assessment and national performance reports, including *NHS in Scotland 2020*
- Support Audit Scotland through engaging in technical guidance publications

Audit process and timeline

Our planned audit timeline is detailed below. In accordance with the Code of Audit Practice and audit Scotland Planning Guidance, we are required to undertake and report on a range of areas. The diagram below summarises our planned audit timetable for 2019/20, and output both to NHS Highland and Audit Scotland.

Our audit timetable assumes receipt of a complete set of draft financial statements and supporting documentation as outlined within our audit deliverables list in advance of our year end audit work. The timetable, and our proposed audit fee, assumes minimal amendments being required to the financial statements through the course of our audit.



Throughout the audit process there will be continuous communication and engagement. We will also continue to engage with Audit Scotland to ensure they are aware of any current or emerging issues at the Board.

Materiality



The NHS Highland Group consists NHS Highland and the Highland Health Board Endowment Funds. The Argyll and Bute Integration Joint Board transactions and balances has been consolidated on an equity basis. We undertake your audit in accordance with International Standards on Auditing (UK) (ISAs) and the Audit Scotland Code of Audit Practice (May 2016). On an annual basis we are required to give an opinion as to whether the Financial Statements:

- give a true and fair view
- have been properly prepared in accordance with relevant legislation and standards
- audited parts of the remuneration and staff report have been prepared in accordance with the guidance
- regularity of expenditure and income
- the wider information contained in the financial statements e.g. Accountability Report; Directors Report; and Governance Statement is consistent with our audit knowledge and the financial statements

Basis for materiality

We determine financial statement materiality based on a proportion of the total operating expenditure. This approach is consistent with our prior year materiality determination. We have determined Group materiality to be **£8.86 million** (Board only: £8.84 million), which equates to approximately **1%** of your budgeted total operating expenditure for the year, adjusted for contributions to the Argyll and Bute Integration Joint Board.

Performance materiality

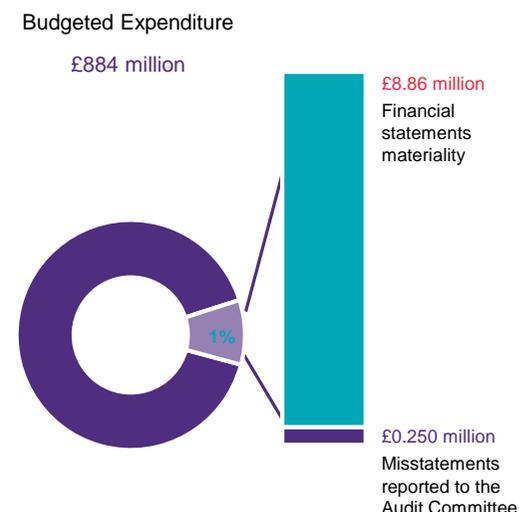
Performance materiality represents the amount set for the financial statements as a whole to reduce the probability that the aggregate of uncorrected and undetected misstatements exceed materiality. Based on our audit experience we have retained this for 2019/20 at **75%**, being **£6.64 million** for the Group (Board only: £6.63 million). Performance materiality determines those accounts which testing will be undertaken on and the level of sample testing performed where applicable. Performance materiality determines those accounts which testing will be undertaken on and the level of sample testing performed where applicable. Performance materiality is set at 75% of overall materiality. This is consistent with the prior year reflecting our audit knowledge and understanding with no material adjustments in the prior year.

Our materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. We will apply a lower materiality threshold on review of the Remuneration and Staff report to ensure that remuneration has been disclosed within appropriate bandings (being **£2,500**).

We will update our materiality based on the unaudited 2019/20 financial statements. During the course of our audit engagement, we will continue to assess the appropriateness of our materiality.

Reporting to those charged with governance

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are required by auditing standards to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. In line with audit Scotland planning guidance we have set this at **£250,000**, being the maximum reporting threshold.



A risk based audit methodology

A core part of audit planning is understanding NHS Highland and the wider health sector. This is our fourth year as the external auditors of the Board appointed under the Audit Scotland framework. Through our audit planning procedures we consider a range of factors to assess the risk of material misstatement to the financial statements.

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Our risk assessment includes the following;

Consideration of critical accounting estimates including the valuation of property, plant and equipment and the valuation of provisions, including defined benefit pension scheme obligations and provisions for clinical and medical negligence claims.

Assessment of inherent risk factors including changes in the organisation's activities and environment

Understanding of entity level controls and the control environment, including IT controls and associated assurances through service auditors including payroll and IT systems (see Appendix 3)

Financial and operational performance during the year, including pressures in delivering outcomes while operating within financial resources limits.

Identified Significant risks

- Risk of fraud in revenue recognition
- Risk of fraud in expenditure recognition
- Management override of controls
- Valuation of property, plant and equipment (land and buildings)

We continue to assess the risk of material misstatement and our response to these risks throughout our audit. Within our Annual Audit Report we will report to you the conclusions from our audit procedures over these risks, including any further risks identified or changes to our planned audit response.

Significant financial statement risks

| Risk area | Areas of focus | Description of risk |
|---|--|---|
| Risk of fraud in revenue recognition (Board) | Other Revenue (at the year end) (Occurrence) Receivables (Existence, Valuation) | As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In 2018/19, NHS Highland's revenue resource allocation was £742 million. While material, we consider this funding to be well forecast and directly agreed to Scottish Government funding letter and draw down. We therefore consider the opportunity and incentive to manipulate this revenue stream as low and rebut the presumed risk around revenue recognition over revenue resource allocation. Similarly, funding from services commissioned from the Integration Joint Board of £202 million and revenue from other Scottish Boards of £30 million is relatively well forecast and agreed to funding letter / inter-Board funding agreements. This reduces the opportunity for manipulation and the inherent risk of material misstatement in revenue recognition. We therefore identify our significant risk is relevant to your other material revenue stream: other revenue . We consider the risk to be most prevalent where there is greatest incentive for fraudulent manipulation. As financial performance targets are primarily set for year end outturn position, the risk is prominent around year end revenue transactions and balances. While the Board face significant pressures to meet financial performance targets in the current year, given the medium term financial outlook there is also a potential incentive to understate revenue to support future years financial position. |

Audit Response

- Walkthroughs of the controls over **other revenue** to gain an understanding of the controls in place over the significant risk area.
- Perform substantive testing (at an elevated risk level) over income recognised in the final two months of the year where there is an increased risk of fraudulent recognition
- Evaluation of the existence of debtor balances held at 31 March 2020 through agreeing balances held to invoices and/or other supporting records.
- Perform income cut-off procedures and substantive testing over pre and post year end balances, over **other income** revenue streams.
- A focus on recoverability of balances through agreeing a sample of debtor balances (at an elevated risk level) and agreeing to post year end cash receipt.

Significant financial statement risks

| Risk area | Areas of focus | Description of risk |
|---|--|--|
| Risk of fraud in Expenditure recognition (Board) | Other Expenditure (at the year end) (Completeness, occurrence) Payables (Completeness, Existence) | <p>Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As set out in Practice note 10 (revised) which applies to public sector entities. NHS expenditure includes payroll expenditure (2018/19: £385 million). As payroll expenditure is well forecast and agreeable to underlying payroll systems there is less opportunity for the risk of misstatement in this expenditure stream. We therefore focus on non-pay expenditure. NHS Highland's non-pay expenditure includes: Independent primary care services; drugs and medical supplies; and, other health care expenditure. Other health care expenditure includes contributions to the Integrated Joint Board (2018/19: 214 million). As these expenditure streams are agreed to third party confirmations at the year end, there is limited opportunity for manipulation of the expenditure and therefore not considered significant risk of misstatement. The only material other health care expenditure stream is other operating expenses.</p> <p>We therefore focus our risk on the following expenditure streams: Independent primary care service; drugs and medical supplies and other operating expenses. For this expenditure we consider there an inherent risk that this may be materially misstated through fraudulent recognition to deliver financial performance targets. Recognising the challenges in meeting financial targets for the current year, incentivising understatement of expenditure, we consider therefore consider the risk to be understatement of expenditure throughout the year. However, given financial pressures in future years, there may be an incentive to overstate expenditure (particularly around the year end when financial outturn more certain) in order to reduce financial pressure in 2020/21.</p> |
| Audit Response | | |
| <p>In advance of our year end testing we will review the financial performance during they year to determine if there is any indication of the focus of our audit risk and whether there is greater incentive of understatement or overstatement of expenditure.</p> <ul style="list-style-type: none"> • Walkthroughs of the controls and procedures over Independent primary care service; drugs and medical supplies and other operating expenses • Perform substantive testing (at an elevated risk level) expenditure recognised post year end to identify if there is any potential understatement • Perform substantive testing (at an elevated risk level) of expenditure in the final two months of the year to identify if this has been potentially overstated • Reviewing accruals, deferred income and provisions, where material, around the year end to consider if there is any indication of understatement or overstatement of balances held through consideration of accounting estimate | | |

Significant financial statement risks

| Risk area | Areas of focus | Description of risk |
|--|--|--|
| Management override of controls (Board) | Journals Accounting Estimates | As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. 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. We consider those key judgements that are most susceptible to significant audit risk of management override are those over expenditure recognition. These are areas where management has the potential to influence the financial statement through estimate and judgement. |

Audit Response

Accounting estimates:

In assessing the risk of management override, consider those key accounting estimates and judgements that could impact on the organisations financial results and where there is an inherently increased risk of fraudulent misstatement or where management bias could result in a material misstatement. In response to the significant audit risk we will:

- consider the design of controls in place over key accounting estimates and judgements
- Review accounting estimates for management bias / indication of fraud that could result in material misstatement. This will include review of estimates as at 31 March 2020 and retrospective review of those estimates as at 31 March 2019. In particular we will review the reasonableness of significant estimates including provisions and defined benefit pension scheme liabilities, assessing the extent to which there is any indication of management bias in estimates made that may result in a material misstatement to the financial statements.

Journals testing:

We will use our data analytics tool *Info* to support our evaluation of journal transactions during the year. In response to the significant risk we will:

- Assess the design of controls in place over journal entries, including how these are prepared, authorised and processed onto the financial ledger;
- Will risk assess the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We will test these journals to ensure they are appropriate and that suitably recorded in the financial ledger;
- We will perform targeted testing of transactions around the financial year end reviewing those journals that are large or otherwise appear unusual to understand the rationale for the transaction.

Significant financial statement risks

| Risk area | Areas of focus | Description of risk |
|--|---|---|
| Valuation of property plant and equipment (Board) | Property, plant and equipment (Land & Buildings) | <p>In accordance with the NHS Accounting Manual and the HM Treasury Financial Reporting Manual (FReM), subsequent to initial recognition, the Board is required to hold property, plant and equipment on a valuation basis. The exact valuation basis depends on the nature and use of the assets. Specialised NHS Land, Buildings, equipment, installations and fittings are held at depreciated replacement cost, as a proxy for fair value. Non-specialised land and buildings, such as offices, are held at fair value. There are further modifications to values depending on the nature and use of assets to ensure PPE is appropriately stated. As at 31 March 2019, NHS Highland held PPE of £354 million, including Land and buildings of £312 million. Given the value of PPE held by the Board and the level of complexity and judgement in the estimation of valuations, there is an inherent risk of material misstatement in the valuation of land and buildings. The risk is less prevalent in non land and buildings assets as these are generally held at depreciated historic costs, as a proxy of fair value and therefore less likely to be materially misstated. NHS Highland appoint Barr (Argyll & Bute) and Burnetts (North Highland) to undertake a rolling programme of valuations across the assets base, valuing land and buildings a minimum of once every five years.</p> |

Audit Response

- Walkthroughs of the controls and procedures over the [valuation of land and buildings](#)
- Understanding the arrangements in place at the board for ensuring the carrying value of land and buildings remains appropriate and in accordance with IAS 16
- Reviewing the underlying assumptions continued within the valuation of land and buildings and the reasonableness of these including the suitability of any indices used in the valuation.
- Reviewing the competency, including objectivity and independence of the valuer.
- Reviewing managements assessment of potential impairment of PPE and considering if there are any indications of impairment of PPE not recognised by the board.
- Reviewing the underlying data supporting the valuation to ensure these are consistent with the board's underlying records and that the valuation as at 31 March 2020 reflects a suitable estimate of the condition and value of land and buildings held.
- Reviewing Management's assessment of the assets subject to revaluation in year (minimum of 20%) to confirm that there is no indication of management bias in assets subject to revaluation in year
- Reviewing how the board satisfy themselves that those assets not revalued at 31 March 2020 are not materially misstated.

Other audit areas

Going concern considerations

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570).

We will review management's assessment of the going concern assumption and evaluate the disclosures in the financial statements, alongside our assessment based on substantive testing and audit procedures. In particular we will focus on management's disclosures in respect of brokerage and how the Board's financial plans align to the medium term financial framework, and how going concern can be determined when receiving support from the Scottish Government in form of brokerage.

Working with Internal Audit

The Auditing Standards Board's version of ISA (UK) 610 “Using the work of internal auditors” prohibits the 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.

During 2019/20, we engage with Internal Audit to confirm any awareness of fraud or suspected fraud. Where Internal Audit have identified specific material deficiencies in the control environment that would create a risk of material misstatement to the financial statements, we will consider adjusting our testing so that the audit risk is covered by our work.

Internal control environment

Throughout our audit planning and fieldwork we will continue to develop our understanding of the overall control environment (design) as related to the financial statements. In particular we will:

- Consider procedures and controls around related parties, journal entries and other key entity level controls including controls to mitigate Management override of controls.
- Perform walkthrough procedures on key controls around identified risk areas including operating income, payroll expenditure, other expenditure, journal entries, property, plant and equipment and accounting estimates including provisions.

International Financial Reporting Standards 16: Leases (IFRS 16)

IFRS 16 was effective for accounting periods beginning on or after 1 January 2019 and is due to be adopted for bodies reporting under the FReM for financial years beginning on or after 1 January 2020 . The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces the previous standard IAS 17. IFRS 16 introduces a single lessee accounting model aimed at providing a fairer representation of a lessee's assets and liabilities and disclosures around these. Under IFRS 16, the lessees' recognises assets and liabilities with a term of more than 12 months, unless the underlying asset is of low value. In practice, this is likely to result in lease or lease type arrangements associated assets and liabilities being recognised in the financial statements of the lessee, where these may have previously been treated as operating leases where there was no asset or liability recognised and only an annual lease charge through expenditure.

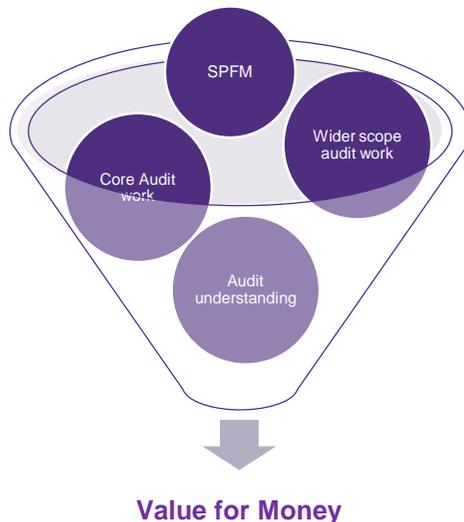
During 2019/20 we will review the progress made by NHS Highland in evaluating the potential implications on adoption of the new accounting standard. This will be reflected in the 2020/21 financial statements. We will consider the disclosures in the 2019/20 financial statements in relation to the anticipated impact of the new standard.

Wider scope audit

Our responsibilities under Audit Scotland's Code of Audit Practice extend beyond the audit of the financial statements. The Code sets out four dimensions that frame wider scope audit work into identifiable areas. Alongside Value for Money, the audit dimensions set a common framework for our audit work and we review and conclude on the four dimensions and that there are organisational arrangements in place to secure Value for Money.



Wider scope approach



Our wider scope audit work is a **risk based** approach. It is built upon our understanding of the organisation and consideration of:

- Scottish Public Finance Manual (SPFM) nine characteristics of Value for Money
- Our core audit work and audit knowledge
- Audit Scotland planning guidance

We consider each of these areas through our audit planning process. We summarise our planning consideration over the wider scope areas below, including where we have identified a significant wider scope risk, our planned audit response. We have also identified areas that we will continue to consider throughout our audit to allow us to conclude on the wider scope areas in our Annual Audit Report.

As part of our wider scope audit work we will consider the findings of the Auditor General's Report: *The 2018/19 audit of NHS Highland*, made under section 22 of the Public Finance and Accountability (Scotland) Act 2000.

Wider scope audit dimensions

Financial sustainability

NHS Highland face significant financial challenges over the short to medium term. The Annual Operating Plan 2019/20 forecasts a funding gap of £39.4 million. Management has estimated that it can deliver £28 million of savings and will therefore require a further £11.4 million of brokerage funding required to meet financial targets. In addition, Management has estimated that a further £6.1 million of brokerage will be required in 2020/21 before forecasting a breakeven position in 2021/22.

Given the financial and operational challenges facing NHS Highland, in November 2018 the Scottish Government escalated the board to level 4 within the ladder of escalation and additional support measures and initiatives have been put in place to assist the board in its aim of returning to financial balance. This has included the establishment of a Transformation Team, reporting to the Scottish Government, to support the Board in returning to financial balance. This has included establishing a Project Management Office (PMO) to help coordinate and deliver transformation activity.

Significant wider scope risk identified: NHS Highland's underlying operating model is currently not financially sustainable without significant changes to service delivery and potentially provision. This is recognised by the leadership team and the Board. During 2019/20, the board is implementing a Transformation Programme, aimed at delivering a financially sustainable operating model while ensuring focus on patient outcomes and the delivery of quality of care in the region. To support this, NHS Highland established a Transformation team and have received Financial turnaround expertise support from the Scottish Government.

Significant wider scope risk identified: Alongside the transformation activity, during 2018/19 the Board rolled out a programme of "grip and control" aimed at ensuring better control of expenditure and budget management. This has continued during 2019/20. While we recognise that cost management is critical within NHS Highland, it is important that cost control measures are aligned to the strategic priorities of the board, including patient outcomes. There is a risk that in order to deliver in year financial targets, cost control measures have an adverse impact on service delivery or the ability and capacity of the board to deliver medium to longer term strategy plans.

Audit response

Response to wider scope risk:

We will review the progress made by NHS Highland in delivering the Transformation Programme and the extent to which the board has developed the underlying operating model to provide a financially sustainable model of care. We will review the extent to which savings delivered during 2019/20 represent sustainable recurring savings and that that changes to the underlying operating model have embedded within the organisation including the extent to which transformation programme is being delivered.

We will consider how the board have evaluated the potential impact on service delivery of proposed savings plans both in the short and medium term.

Other wider scope procedures:

In relation to broader financial sustainability we will continue to develop our understanding of the Boards financial planning arrangements including workforce plans and how these developed both supporting and recognising the financial and operational challenges facing the board.

Audit response

Response to wider scope risk:

We will review the cost control measures established by NHS Highland during the year and how decisions taken are aligned both to the board's Operating Plan as well as the wider transformation programme, to ensure that cost control measures, including vacancy management, do not adversely impact the deliver of these.

Wider scope audit dimensions

Financial management

NHS Highland faces significant financial pressures in meeting its financial reporting targets for 2019/20. The board is projecting a breakeven position for 2019/20 on the assumption that it will receive brokerage funding of £11.4 million from the Scottish Government. However, to achieve this NHS Highland will need to deliver in year efficiency savings of £28 million in the current year, representing over 3% of annual budgeted expenditure.

During 2018/19 the board delivered savings of £26.6 million. However, of the original planned savings, £4.9 million were not achieved in year and £9.5 million of savings were only delivered on a non-recurring basis.

With NHS Highland being escalated to level 4 on the Scottish Government's ladder of escalation there is increased focus on financial performance of the Board throughout the year. We have found that financial monitoring reports are clear and transparent and reported to the Board in a timely manner.

Significant wider scope risk identified: During 2018/19, through vacancy management and recruitment challenges, NHS Highland reported an underspend on payroll costs against budget of £4.5 million. With challenges in recruitment of key clinical posts in both primary and secondary care, NHS Highland relied upon medical locum services with expenditure totally £15.6 million in 2018/19. A key focus for NHS Highland is reducing the pressures on vacancy management, ensuring that NHS Highland has the appropriate workforce in order to ensure the provision of safe clinical care.

Significant wider scope risk identified: During 2019/20, the Scottish Government have provided additional strategic support to NHS Highland, including the establishment of a Transformation Team and a Programme Management Office (PMO), alongside financial recovery expertise. PricewaterhouseCoopers UK LLP (PwC) provided advice and support around the delivery of savings and development of the PMO over a contracted period. While NHS Highland have reported good progress in the delivery of transformational savings in the year, over the longer term there is a significant risk that NHS Highland will not have the skills, capacity or capability to progress and realise the savings plans developed by PwC and Scottish Government Transformational Teams or full utilise the PMO framework established. This pressure becomes particularly acute at NHS Highland, as the Board has existing capacity challenges within the Board, including inability to recruit a permanent director of finance, to support transformational activity over the medium term.

Audit response

Response to wider scope risk

Alongside our wider scope work around financial sustainability, we will consider the Boards arrangements for assessing workforce capacity and capability and the extent to which staff costs, including secondment costs are controlled.

We will consider the work done by NHS Highland in addressing recruitment challenges in key staffing cohorts and how financial planning and management arrangements are built upon a sustainable workforce model to prevent the board becoming overly reliant on vacancy management to meet financial targets. In particular, we will review the progress made by NHS Highland in the recruitment of a Director of Finance and the boards medium term plans around financial management operating model.

Other wider scope procedures

We will continue to review the Board's financial management arrangements including the extent to which there is effective scrutiny over both operational spend as well as delivery of savings plans. Our work will consider the extent to which the performance impact of in year savings is monitored.

Audit response

Response to wider scope risk

We assess the arrangements established by NHS Highland to ensure the board has the skills, capability and capacity to support the delivery of the transformation programme both in 2019/20 and beyond. This will include the extent to which the PMO framework established by PwC has transitioned to the board and that NHS Highland assures itself that it has the resources and capability to deliver transformation.

Wider scope audit dimensions

Governance and transparency

NHS Highland is going through a period of significant transformation. Over the last 18 months, there have been changes in the senior management team, including a new Chief Executive as well as the appointment of an interim Chair of the Board. In addition, to support the Board address the financial challenges faced, the Scottish Government has provided specialist support to the Board, including the appointment of an interim Deputy Chief Executive. As the board looks at delivering a significant savings programme, it is critical that there is effective oversight, scrutiny and accountability of these arrangements to ensure effective governance within the organisation.

Significant risk identified: With the number of interim appointments, as well as members of the senior management team who have no formal contractual arrangement with NHS Highland, there is a risk that there will not be stable leadership in place, with clear accountability to make the difficult decisions NHS Highland will face in the coming years.

Significant risk identified: In response to the John Sturrock QC review: *Bullying and Harassment in NHS Highland* (the Sturrock Report), that found that bullying or inappropriate behaviour has occurred within NHS Highland, the board have been implementing a range of actions aimed at addressing the shortcomings identified in the report. This includes being able to hold senior executives to account and reviewing its structures, committee network and culture. Allied to this the board has reviewed its management structure to ensure this remains fit for purpose.

Audit response

Response to wider scope risk:

We will review the governance arrangements established by NHS Highland to ensure appropriate board oversight and scrutiny of transformation activity being undertaken across NHS Highland. We will consider the extent to which clear lines of accountability and transparency in decision making are in place across the board, ensuring NHS Highland can demonstrate clear ownership of transformation and turnaround activity being undertaken by external appointments.

Other wider scope procedures:

To support our wider scope audit, we will continue to consider through discussions with management and review of minutes NHS Highland's overarching governance arrangements. We will consider the extent to which these reflect good practice.

We will consider the progress made by NHS Highland in implementing the opportunities for improvement identified in the self-assessment against NHS Scotland's Blueprint for Good governance identified opportunities for improvement.

Audit response

Response to wider scope risk

We will consider the progress made by NHS Highland in implementing the actions identified to address the shortcomings raised in the Sturrock Report. We will consider the extent to which these arrangements have embedded across the organisation and how the board satisfies itself that these issues have been addressed. This will include the extent to which the board has established clear and transparent arrangements to support both existing or historic cases of bullying or harassment to be appropriately considered, and where required, addressed by the board. In addition, we will consider how the Board satisfies itself that it has appropriate skills and capability across the Board and that there are suitable board recruitment and training arrangements in place to support the Board's development.

Wider scope audit dimensions

Value for money

During 2018/19, NHS Highland saw a decline in its performance against NHS Scotland standard operating standards, with the board achieving less than 25% of the targets in year. In the context of significant financial challenges, it is essential that the board priorities the use of resources to address performance challenges.

NHS Highland has recognised the performance issues facing the organisation and that the efficient and effective use of resources is critical to the long term financial sustainability of NHS Highland. The newly established PMO function will play a key role in supporting the timely and accurate reporting of financial and non-financial performance information to support oversight, scrutiny and effective decision making.

NHS Highland has a number of strategic proposals in place to develop and transform services to meet the demands of the local population in the Highlands, whilst delivering a financial sustainable model of care. This includes the development of the Elective Care Centre in Inverness, working in partnership with the University of the Highlands & Islands and Highlands & Islands Enterprise to deliver a different model of care through research, development and innovation. Furthermore, during 2020 NHS Highland and the Highland Council are reviewing the lead agency agreement between the parties to consider the extent to which the arrangement supports an effective and sustainable model of care.

Audit
response

NHS Highland recognise the challenge in delivering performance targets and are actively seeking financially sustainable solutions to enhance the level of care provided.

While no significant wider scope risks have been identified in relation to value for money, we will continue to review the Board's performance against the annual operating plan standards, the Boards reporting and monitoring of these and the actions taken to improve the performance of the Board.

We will consider the extent to which NHS Highland can demonstrate value for money in the level of professional consultancy support received during the year including financial and project management. In addition, we will consider the arrangements in place at NHS Highland to ensure appropriate controls and oversight of agency staffing costs and work underway to reduce these costs.

We will assess the progress made by NHS Highland in the development of the Elective Care Centre as well as progress made in evaluating the existing lead agency model with the Highland Council to ensure that any arrangement going forward is fit for purpose and financially viable for the board.

Audit deliverables

As set out in the Code of Audit Practice, as appointed auditors we have a number of wider reporting responsibilities beyond the audit of the financial statements. Below we summarise the key areas of work during our 2019/20 audit, including expected reporting under Audit Scotland's Code of Audit Practice and audit planning guidance (2018/19 Guidance on Planning the Audit)

| Requirement | How we will report our findings |
|---|--|
| <p>Annual accounts Perform an audit of the annual accounts and express and express specified audit opinion on them.</p> | <ul style="list-style-type: none"> • External audit plan • External auditor's opinion on the financial statements • Annual external audit report findings from our audit work of the financial statements |
| <p>Wider scope audit dimensions Conclude and report on our assessment of the wider scope audit dimensions</p> | <ul style="list-style-type: none"> • Annual external audit report (audit findings report) |
| <p>National Fraud Initiative Evaluate the Boards participation in the National Fraud initiative</p> | <ul style="list-style-type: none"> • Annual external audit report (audit findings report) • Reporting participation to Audit Scotland including completion of NFI questionnaire |
| <p>Performance and NHS overview reports Contribute to performance audits (including overview reports, performance audit reports, and impact reports)</p> | <ul style="list-style-type: none"> • Submission of datasets to Audit Scotland of key financial and non-financial data of the body • Providing Information returns to Audit Scotland |
| <p>Intelligence sharing Share intelligence with health and social care national agencies</p> | <ul style="list-style-type: none"> • Intelligence returns to Audit Scotland sharing our knowledge and understanding of the Board to support shared intelligence gathering across health and social care national agencies |
| <p>Emerging issues Communication of emerging issues to Audit Scotland and highlight any issues for potential statutory reports</p> | <ul style="list-style-type: none"> • Communicating throughout our audit emerging issues throughout the year |
| <p>Correspondence queries Carry out preliminary enquiries into any correspondence relevant to the Board that is referred to Audit Scotland.</p> | <ul style="list-style-type: none"> • Providing responses to any correspondence received based on our audit knowledge and understanding and the results of any review as agreed with Audit Scotland |
| <p>Whole of Government Accounts Provide assurance over the Board's Whole of Government Accounts (WGA) returns</p> | <ul style="list-style-type: none"> • Providing Assurance Statement to HM Treasury over the Board's WGA return. |
| <p>Money laundering and fraud Provide information on cases of money laundering or fraud</p> | <ul style="list-style-type: none"> • Reporting cases to the National Crime Agency of an instances of money laundering at the Board and identified frauds to Audit Scotland |
| <p>Technical guidance Contribute to Technical Guidance Notes</p> | <ul style="list-style-type: none"> • Providing responses to Audit Scotland consultations on draft Technical Guidance notes for Auditors. |

Audit deliverables

| Requirement | How we will report our findings |
|---|---|
| <p>Audit Scotland area of focus - Procurement</p> <p>In accordance with Audit Scotland's planning guidance, during 2019/20 we will have particular audit focus around the risk of fraud and corruption in NHS Highland's procurement arrangements. We will evaluate the arrangements at the audited body to mitigate that risk, auditors may wish to consider whether:</p> <ul style="list-style-type: none">• Procurement risk is recognised and managed with key owner;• controls around the procurement process, including segregation of duties, are adequate, followed and enforced• Appropriate policies and procedures in place around procurement including gifts and hospitality• Capacity and capability to undertake procurement activity• internal audit coverage of procurement systems is adequate and proportionate to the risks faced by the body• There are arrangements to encourage and protect whistle-blowers. | <ul style="list-style-type: none">• Our audit work will consider the arrangements for the prevention and detection of fraud and corruption. Specifically, we will consider the extent to which the Board follows the principles of CIPFA's Code of Practice on Fraud. Our conclusions will be reported in our 2019/20 Annual External Audit Report. |

Appendices

Appendices:

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Appendix 1: Fees and independence

External Audit Fee

| Service | Fees £ |
|--|----------------|
| External Auditor Remuneration | 157,177 |
| Pooled Costs | 16,670 |
| Contribution to Audit Scotland costs | 8,420 |
| Contribution to Performance Audit and Best Value | - |
| 2019/20 Fee | 182,267 |

Fees for other services

| Service | Fees £ |
|--|--------|
| At planning stage we confirm there are no non-audit fees | Nil |

Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.
- We have complied with the Financial Reporting Council's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.
- Full details of all fees charged for audit and non-audit services will be included in our Annual Report to those charged with governance at the conclusion of the audit.
- We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standards.
- We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.
- We can confirm no independence concerns have been identified.

Audit Scotland sets an expected fee for each audit carried out under appointment which assumes that the body has well-functioning controls, an effective internal audit service, and an average risk profile.

Audit Scotland reviews the expected fee each year and adjusts it if necessary based on auditors' experience, new requirements, or significant changes to audited bodies. The audit fee is calculated in accordance with guidance issued by Audit Scotland. In accordance with the Audit Scotland guidance we can increase the auditor remuneration element of the fee by up to 10% from the base fee set by Audit Scotland, depending on risk factors identified by us as your external auditors. We cannot reduce the fee from the baseline set out by Audit Scotland. For 2019/20 we have agreed with Management an audit fee of £182,267, representing a 6% uplift on the auditor remuneration element of the fee from the Audit Scotland baseline. This reflects the additional costs in delivering the audit including: using our own audit expert to support the valuation of land and buildings; using an internal actuarial specialist to support our assessment of the defined benefit pension scheme actuarial assumptions; and planned audit work around additional wider scope risks including follow up of NHS Highland's Section 22 Report from the Auditor General for Scotland. The fee is based on the following assumptions:

- supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- the scope of the audit, and the Boards' activities will not change significantly from planned
- NHS Highland will make available management and accounting staff to help us locate information and to provide explanations. We reserve the right to charge an additional fee for any additional work.
- We will only receive (and audit) 3 sets of accounts (1st draft; amended draft and final)

Client service

We take our client service seriously and continuously seek your feedback on our external audit service. Should you feel our service falls short of expected standards please contact Joanne Brown, Head of Public Sector Assurance Scotland in the first instance who oversees our portfolio of Audit Scotland work (joanne.e.brown@uk.gt.com). Alternatively, should you wish to raise your concerns further please contact Jon Roberts, Partner and Head of Assurance, 30 Finsbury Square, London, EC2A 1AG. If your feedback relates to audit quality and we have not successfully resolved your concerns, your concerns should be reported to Elaine Boyd, Assistant Director, Audit Scotland Quality and Appointments in accordance with the Audit Scotland audit quality complaints process.

Appendix 2: Fraud arrangements

The term fraud refers to intentional acts of one or more individuals amongst management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is alert to the possibility of fraud at NHS Highland.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relations to management override of controls.
- Leading a discussion with those charged of governance (for NHS Highland this is assumed to be the Audit Committee) on their view of fraud. Typically we do this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit.

As auditors we obtain reasonable but not absolute assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

Anti-Money Laundering Arrangements

As required under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 there is an obligation on the Auditor General (as set out in the planning guidance) to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. Should we be informed of any instances of money laundering at NHS Highland we will report to the Auditor General as required by Audit Scotland.

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.

It is NHS Highland responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we work with NHS Highland to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

In addition, as set out in the Audit Scotland Code of Audit Practice we have a role in reviewing NHS Highland arrangements in response to the national fraud initiative exercise.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on a quarterly basis.

Appendix 3: Service auditor reports

NHS Highland utilise a number of shared IT systems, IT applications and processes with other Scottish health boards. Assurance reports are prepared by service auditors in the health sector under ISA (UK) 402 covering the national systems/arrangements:

| Shared service | Service assurance |
|--|--|
| <p>Primary care payments This arrangement covers payments made by NHS National Services Scotland (NSS) to primary care practitioners on behalf of health boards for general medical services, general dental services, general ophthalmic services and general pharmaceutical services.</p> | <p>NSS procures a service auditor report from KPMG which will be issued in May 2020 to the health boards concerned. The external auditor of the NSS (Audit Scotland) will review the work of the service auditor and report the results of the review to other health board external auditors.</p> |
| <p>National IT contract This contract covers the services provided by ATOS Origin Alliance e.g. controls over the server supporting eFinancials.</p> | <p>NSS procures a service auditor report from KPMG which will be issued in May 2020 to the health boards concerned.</p> |
| <p>National Single Instance (NSI) eFinancials NHS Ayrshire & Arran host this eFinancials service including the Real Asset Management system on behalf of all Scottish health boards.</p> | <p>NHS Ayrshire and Arran procure a service auditor report from BDO which will be issued in May 2020 to the health boards concerned.</p> |

As part of our consideration of IT systems, applications and IT controls we will consider the service auditor reports and consider the impact on the board's control environment.

Appendix 4: Communication with those charged with governance

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table above.

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while our Annual Report to those Charged with Governance will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to NHS Highland Management and the Audit Committee.

| Our communication plan | Audit Plan | Audit Findings |
|---|-------------------|-----------------------|
| Respective responsibilities of auditor and management/those charged with governance | • | |
| Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks | • | |
| Confirmation of independence and objectivity | • | • |
| A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence | • | • |
| Significant matters in relation to going concern | • | • |
| Views about the qualitative aspects of NHS Highland's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures | | • |
| Significant findings from the audit | | • |
| Significant matters and issues arising during the audit and written representations that have been sought | | • |
| Significant difficulties encountered during the audit | | • |
| Significant deficiencies in internal control identified during the audit | | • |
| Significant matters arising in connection with related parties | | • |
| Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements | | • |
| Non-compliance with laws and regulations | | • |
| Unadjusted misstatements and material disclosure omissions | | • |
| Expected modifications to the auditor's report, or emphasis of matter | | • |



The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the entity or all weaknesses in your internal controls.

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