



# NHS Lothian

External Audit Annual Plan  
2021/22

February 2022



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# Introduction



## Introduction

1. This document summarises the work plan for our 2021/22 external audit of NHS Lothian (“the Board”).
2. The core elements of our work include audits of:
  - the 2021/22 annual report and accounts and related matters;
  - the Board’s arrangements for governance and transparency, financial management, financial sustainability and value for money;
  - the Board’s participation in the National Fraud Initiative (NFI); and
  - any other work requested by Audit Scotland.
3. 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.
4. Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions, including monitoring the performance of auditors through a quality control process.
5. The Auditor General has appointed Azets as external auditor of NHS Lothian for the six year period 2016/17 to 2021/22<sup>1</sup>. This document reflects the audit plan for 2021/22 and summarises;
  - the responsibilities of Azets as the external auditor;
  - our strategy;
  - our planned audit work and how we will approach it;
  - our proposed audit outputs and timetable; and
  - background to Azets and the audit team.

## Audit appointment

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4. Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions, including monitoring the

## Auditor independence

6. International Standards on Auditing in the UK require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.
7. We confirm that we comply with the Financial Reporting Council’s (FRC) Ethical Standard. In our professional judgement, we are independent and our objectivity is not compromised in any way.
8. We set out in Appendix 2 our assessment and confirmation of independence.

<sup>1</sup> In October 2020, the Auditor General extended our audit appointment for one year through to the audit of

the 2021/22 financial year to provide continuity and stability in the current challenging environment.

## Adding value through the audit

9. All of our clients demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Board through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Board promote improved standards of governance, better management and decision making and more effective use of resources.

## Feedback

10. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to any member of your audit team.

## Openness and transparency

11. This report will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

# Respective responsibilities of the auditor and the Board



# Respective responsibilities of the auditor and the Board

## Auditor responsibilities

### Code of Audit Practice

12. The Code of Audit Practice outlines the responsibilities of external auditors appointed by the Auditor General for Scotland and it is a condition of our appointment that we follow it.

### Our responsibilities

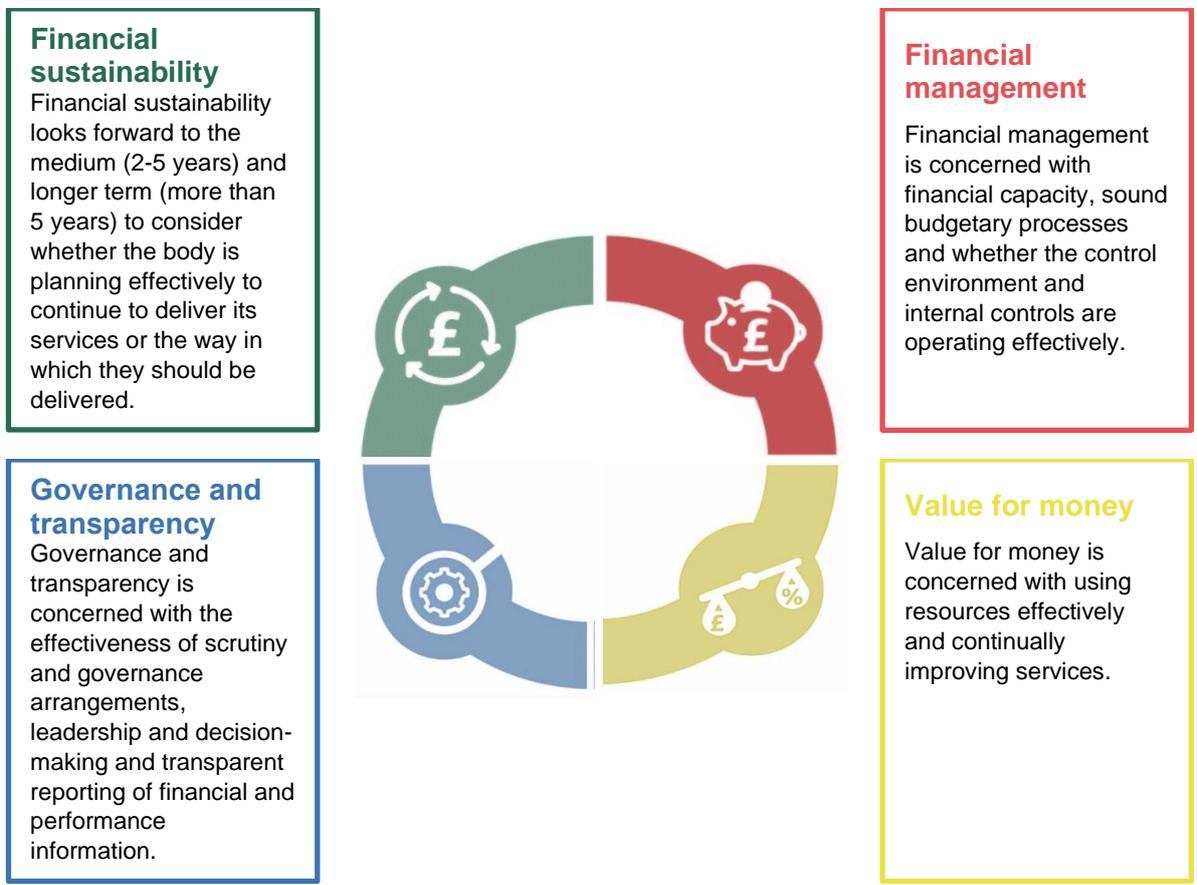
13. Auditor responsibilities are derived from statute, the Code of Audit Practice, International Standards on Auditing (UK), professional requirements and best practice. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards
- provide an opinion on the financial statements and the regularity of transactions
- review and report on, as appropriate, other information such as annual governance statements, management commentaries and remuneration reports
- notify the Auditor General when circumstances indicate that a statutory report may be required
- demonstrate compliance with the wider scope of public audit.

### Wider scope audit work

14. The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.
15. The Code of Audit Practice sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.

**Exhibit 1: Audit dimensions within the Code of Audit Practice**



- 16. We have concluded that application of the full wider scope is appropriate at NHS Lothian.
- 17. Weaknesses or risks identified by the audit are only those which have come to our attention during our normal audit work in accordance with the Code and may not be all that exist. Communication by Azets of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

**Board responsibilities**

- 18. The Board has primary responsibility for ensuring the proper financial stewardship of public funds, complying with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives. The Board’s responsibilities are summarised in Exhibit 2.

## Exhibit 2: Board responsibilities

Area	NHS Lothian responsibilities
<p><b>Financial statements:</b> Annual accounts containing financial statements and other related reports should be prepared.</p>	<p>The Board has responsibility for:</p> <ul style="list-style-type: none"> <li>• preparing financial statements which give a true and fair view of its financial position and its expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation</li> <li>• maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support its financial statements and related reports disclosures</li> <li>• ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority</li> <li>• maintaining proper accounting records</li> <li>• preparing and publishing, along with the financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements.</li> </ul>
<p><b>Financial sustainability:</b> Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfil its functions in an affordable and sustainable manner.</p>	<p>The Board is responsible for putting in place proper arrangements to ensure the financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>• Such financial monitoring and reporting arrangements as may be specified;</li> <li>• Compliance with any statutory financial requirements and achievement of financial targets;</li> <li>• Balances and reserves, including strategies about levels and their future use;</li> </ul>

**Area** **NHS Lothian responsibilities**

- How the organisation plans to deal with uncertainty in the medium and long term; and
- The impact of planned future policies and foreseeable developments on the financial position.

**Financial management:**

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

The Board is responsible for ensuring that financial affairs are conducted in a proper manner. Management are responsible, with the oversight of those charged with governance, for communicating relevant information to users about the entity and its financial performance.

The Board is responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at its disposal.

The Board is responsible for establishing arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct.

**Governance and transparency:**

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

The Board, through its Chief Executive (as accountable officer), is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Those charged with governance should be involved in monitoring these arrangements.

The Board is also responsible for establishing effective and appropriate internal audit and risk management functions.

Area	NHS Lothian responsibilities
<p><b>Value for money:</b> Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.</p>	<p>Accountable officers have a specific responsibility to ensure that arrangements have been made to secure best value. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.</p>

# Audit strategy

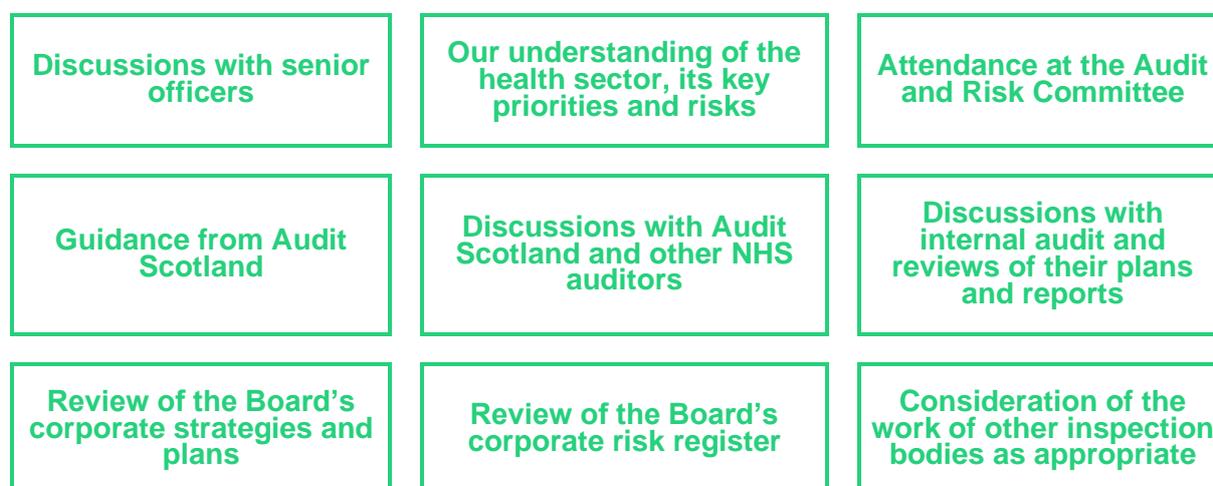


## Audit strategy

### Risk-based audit approach

19. We follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Board. This ensures that

our audit focuses on the areas of highest risk. Our audit planning is based on:



20. Planning is a continuous process and our audit plans are therefore updated during the course of our audit to take account of developments as they arise.

### Communication with those charged with governance

21. Auditing standards require us to make certain communications throughout the audit to those charged with governance. We have agreed with the Board that these communications will be through the Audit and Risk Committee (which then reports to the Board). The financial statements and our annual report will also be reported to the Board.

### Professional standards and guidance

22. We perform our audit of the financial statements in accordance with International Standards on Auditing (UK (ISAs (UK))), the International Standard on Quality Control 1 (UK), Ethical Standards, and applicable Practice Notes and other guidance issued by the Financial Reporting Council (FRC).

### Partnership working

23. We will coordinate our work with Audit Scotland, internal audit, other external auditors and relevant scrutiny bodies, recognising the increasing integration

of service delivery and partnership working within the public sector.

## Audit Scotland

24. Although we are independent of Audit Scotland and are responsible for forming our own views and opinions, we do work closely with Audit Scotland throughout the audit. This helps, for example, to identify common priorities and risks, treat consistently any issues arising that impact on a number of audited bodies, and further develop an efficient and effective approach to public audit. We will share information about identified risks, good practices and barriers to improvement so that lessons to be learnt and knowledge of what works can be disseminated to all relevant bodies.
25. Audit Scotland undertakes national performance audits on issues affecting the public sector. We may review the Board's arrangements for taking action on any issues reported in the national performance reports which may have a local impact. We also consider the extent to which the Board uses the national performance reports as a means to help improve performance at the local level.
26. During the year we may also be required to provide information to Audit Scotland to support the national performance audits or provide information to support the assessment of the impact of specified published performance audit reports.

## Sharing intelligence for health and social care

27. The Sharing Intelligence for Health and Social Care Group enables seven national agencies<sup>2</sup> to share and consider intelligence about the quality of health and social care systems across Scotland. The aim of the group is to support improvement in the quality of health and social care. When any of the agencies has a potentially serious concern about a health and social care system, the group ensures this is shared and acted upon appropriately.
28. We are required to complete an intelligence return and attend the group meeting when the Board is being considered. Attendance at the meeting also provides us with the opportunity to hear intelligence from other agencies.
29. NHS Lothian was last considered by the group in April 2021. Based on the discussions at the meeting, the group agreed there were no actions beyond those already planned that any of the seven national agencies needed to take.
30. Through our involvement in the Sharing Intelligence for Health and Social Care Group and enquiry of Board management as part of our initial planning discussions, we have not identified any other inspection work planned for 2021/22 which is directly relevant to our audit, other than the work of internal audit and Audit Scotland. We will monitor the

<sup>2</sup> The seven national agencies referred to are: Healthcare Improvement Scotland, NHS Education for Scotland, the Care Inspectorate, Audit Scotland, the Scottish Public Services Ombudsman, the Mental

Welfare Commission for Scotland, and Public Health Scotland.

situation over the course of 2021/22 and update our plans as necessary. We will also monitor developments in relation to the independent public enquiry covering the Royal Hospital for Children and Young People, Department of Clinical Neurosciences and Child and Adolescent Mental Health Services.

## Internal Audit

31. We will consider the work of internal audit within our audit process and look to minimise duplication of effort, to ensure the total audit resource to the Board is used as efficiently and effectively as possible.

## Shared systems and functions

32. Audit Scotland encourages auditors to seek efficiencies and avoid duplication of effort by liaising closely with other external auditors, agreeing an appropriate division of work and sharing audit findings. The Board also uses the National Single Instance (NSI) e-financials services (financial ledger services hosted by NHS Ayrshire and Arran). The appointed auditors to these organisations will share with us their findings on work carried out on those systems.

## COVID-19 – impact on our 2021/22 audit strategy

33. The COVID-19 pandemic has had, and continues to have, a significant and profound effect on Scottish society.
34. We appreciate that different organisations have been impacted differently by COVID-19, as have finance teams, and some

organisations are better set up for remote working. We also know that plans can change quickly and it only takes the absence of one key member of staff from a finance team to have a big impact. Equally our own teams may also be impacted by the pandemic. The wellbeing of our clients and our staff is paramount. Maintaining a pragmatic and flexible approach will enable change at short notice as new issues emerge, or current risks change in significance.

## Remote working

35. We are operating on the basis that we will carry out our 2021/22 audit remotely, whilst keeping this under a watching brief. As in previous periods of auditing during the pandemic, we have the following arrangements in place:
  - All of our people have the equipment, technology and systems to allow them to work remotely, including secure access to all necessary data and information.
  - All of our staff are fully contactable by email, phone call and video-conferencing.
  - Meetings are held over Skype, Microsoft Teams or by telephone.
  - We are keeping all of our staff fully up to date with the latest government guidance in order to keep everyone as safe as possible.
36. If resourcing levels in any part of our business are compromised due to illness or inability to work, we will refocus our teams as necessary to deliver to deadlines. Our teams are holding regular catch ups to allow us

to re-prioritise workloads as necessary.

### Secure sharing of information

37. We use a cloud-based file sharing service that enables users to easily and securely exchange documents.

### Audit evidence

38. Working remotely, does unfortunately result in the audit team requesting audit evidence which we would have previously obtained through other means, for example, face to face meetings or access to systems and client premises.
39. Where required we will consider other ways in which we can obtain audit evidence or carry out alternative audit procedures.
40. We will employ greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.

### Regular contact

41. During the 'fieldwork' phase of our audit, we will look to agree regular catch-ups with key personnel to discuss the progress of the audit. The frequency of these meetings will be discussed and agreed with management.

### Audit reporting

42. It may be that the current circumstances lead to more modified opinions in auditor's reports, than would typically have been the case in previous years.
43. Where necessary, we will engage with the Audit and Risk Committee to explain the implications of our proposed report and consider whether

there are other procedures that could be undertaken, at a future point yet to be determined, which could mitigate any modification either fully or in part.

44. Sufficient time should be set aside by the Audit and Risk Committee to allow for comprehensive, complete and informed communication with the auditor. This will need to take account of the potential for extended communication to explain any modified audit reports, or to report any higher than expected deficiencies or misstatements, that may result from the current circumstances.
45. Audit Scotland uses a system for electronic signatures (DocuSign) that it recommends all bodies use for signing annual accounts. Annual accounts signed electronically are acceptable for laying in Parliament.
46. Electronic signatures simplify the process of signing the accounts. Accounts can be signed using any device from any location. There is no longer a need for duplicate copies to be signed, thus reducing the risk of missing a signature and all signatories have immediate access to a high quality PDF version of the accounts.
47. We propose using DocuSign in 2021/22.

# Annual report and accounts



## Annual Accounts

### Introduction

48. Audited bodies' annual accounts are an essential part of accounting for their stewardship of the resources made available to them and their financial performance in the use of those resources. This section sets out our approach to the audit of the Board's annual report and accounts.
49. The annual report and accounts comprise the financial statements, the performance report and the accountability report.

### Approach to audit of the financial statements

50. Our opinion on the financial statements will be based on:

#### Risk-based audit planning

51. We focus our work on the areas of highest risk. As part of our planning process we prepare a risk assessment highlighting the audit risks relating to each of the key systems on which the financial statements will be based.

#### An audit of key systems and internal controls

52. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements.
53. The systems we review and the nature of the work we perform will be based on the initial risk assessment. We will examine and test compliance with best practice and the Board's own policies and procedures.

54. We will take cognisance of any relevant internal audit reviews of systems and controls.
55. Since the start of the pandemic, the risk of fraud and error has increased as the control environment and internal controls change. Potential areas of risk include:
- Public sector staff working under extreme pressure leading to some internal controls being suspended or relaxed;
  - Procurement fraud or normal controls being relaxed to allow bodies to buy goods or services which are required urgently, possibly from new suppliers;
  - Weakened governance arrangements;
  - Admin and finance staff being redeployed to operational areas; and
  - Staff working remotely may pose potential security risks, e.g. when using personal devices and/or using removable devices to download data.
56. We will update the risk assessment following our evaluation of systems and controls, considering the impact the pandemic has had on the Board's accounting systems and controls. This will ensure that we continue to focus attention on the areas of highest risk.
57. This work is not for the purpose of expressing an opinion on the effectiveness of internal controls. We will report to you significant deficiencies in internal controls that we

identify during the audit. These matters will be limited to those which we conclude are of sufficient importance to merit being reported to you. The scope of our work is not designed to be an extensive review of all internal controls.

#### Prevention and detection of fraud or error

58. We plan our audit in such a way as to obtain reasonable assurance of detecting material misstatements in the financial statements resulting from fraud or error.
59. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
60. We will assess the susceptibility of the Board's financial statements to material misstatement, including obtaining an understanding of how fraud might occur, by:
- making enquiries of management as to where they considered there was susceptibility to fraud, their knowledge of actual, suspected and alleged fraud; and
  - considering the internal controls in place to mitigate risks of fraud and non-compliance with laws and regulations.
61. Our work as auditor is not intended to identify any instances of fraud of a non-material nature and should not be

relied upon for this purpose. Material misstatements that arise due to fraud can be harder to detect than those that arise from error as they may involve deliberate concealment or collusion.

#### Laws and regulations

62. We plan and perform our audit recognising that non-compliance with statute or regulations may materially impact the financial statements. Our audit procedures include the following:
- Identification of the laws and regulations applicable to the Board through enquiries with management, and from our knowledge and experience of the Board and sector;
  - A focus on specific laws and regulations which we consider may have a direct material effect on the financial statements or the operations of the Board;
  - Reviewing minutes of relevant meetings;
  - Enquiring of management and the Board's legal representatives the position in relation to litigation, claims and assessments; and
  - Performing detailed testing of transactions and balances.
63. There are however inherent limitations in our audit procedures described above. The more removed that laws and regulations are from financial transactions, the less likely it is that we would become aware of non-compliance.

#### A final audit of the financial statements

64. During our final audit we will test and review the material amounts and disclosures in the financial statements.

- The extent of testing will be based on our risk assessment.
65. Our final audit will seek to provide reasonable assurance that the financial statements are free from material misstatement and comply with the HM Treasury Financial Reporting Manual 2021/22 (FRoM) and the Accounts Directions issued by Scottish Ministers.
66. In order to provide assurance on the regularity of transactions, we also review whether, in all material respects, expenditure has been incurred and income applied in accordance with guidance issued by Scottish Ministers.
- Independent auditor's report**
67. Our opinion on whether the financial statements give a true and fair view of the financial position and net expenditure and of the regularity of transactions will be set out in our independent auditor's report which will be included in the annual report and accounts.
68. We also provide an opinion on the audited part of the remuneration report, annual governance statement and performance report.
- Group audit**
69. The Board prepares its annual report and accounts on a group basis. The group consists of the Board, the Lothian Health Board Endowment Fund and the four integration joint boards (Edinburgh, West Lothian, Midlothian and East Lothian).
70. The Endowment Fund is fully consolidated. Income and net expenditure for the endowment fund is expected to be immaterial. Whilst the Board expects the endowment fund to hold a material level of assets at 31 March 2022, the level is not expected to be significant to the group overall (reflecting less than 10% of group assets).
71. The integration joint boards are deemed joint ventures with the respective local authority and accounted for under the equity method. The consolidation of the joint boards is expected to be immaterial to the financial statements as a whole in net terms.
72. As group auditors under ISA (UK) 600 we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The following table sets out the components within the group:

Component	Significant	Level of response required	Planned audit approach
NHS Lothian	Yes	Comprehensive	Full scope statutory audit
Lothian Health Board Endowment Fund	No	Analytical	Desktop review
Edinburgh Integration Joint Board	No	Analytical	Desktop review
West Lothian Integration Joint Board	No	Analytical	Desktop review
Midlothian Integration Joint Board	No	Analytical	Desktop review
East Lothian Integration Joint Board	No	Analytical	Desktop review

**Analytical** - the component is not significant to the Group and audit risks can be addressed sufficiently by applying analytical procedures at the Group level

### Materiality

73. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement. We review our assessment of materiality throughout our audit.
74. Performance materiality is the working level of materiality used throughout the audit. We use performance materiality to determine the nature, timing and extent of audit procedures carried out. We perform audit procedures on all transactions, or group of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be at significant risk of material misstatement.
75. Performance materiality is set at a value less than overall materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed overall materiality.
76. Our initial assessment of materiality and performance materiality is set out in the table below:

	Group £million	Board £million	Explanation
Overall materiality for the financial statements	30.0	30.0	Our initial assessment is based on approximately 1.5% of the Board's Revenue Resource Limit (RRL). Achieving a breakeven position against RRL is a key target for the Board and one of the principal considerations for the users of the financial statements when assessing financial performance.
Performance materiality	19.5	19.5	Using our professional judgement we have calculated performance materiality at approximately 65% of overall materiality.
Trivial threshold	0.25	0.25	We will report any misstatements identified through our audit that fall into one of the following categories: <ul style="list-style-type: none"> <li>• All material corrected misstatements;</li> <li>• Uncorrected misstatement with a value in excess of £250,000; and</li> <li>• Other misstatements below £250,000 threshold that we believe warrant reporting on qualitative grounds.</li> </ul>

### Key audit risks in the financial statements

77. Auditing standards require that we inform the Audit and Risk Committee of our assessment of the risk of material misstatement in the financial statements. We have set out our initial assessment below, including how the scope of our audit responds to those risks. We will provide an update to the Audit and Risk Committee if our assessment changes significantly during the audit.

## Exhibit 3 – Key audit risks in the financial statements

### Management override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the financial statements. This is treated as a presumed risk area in accordance with ISA (UK) 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

78. In response to this risk we will review the Board's accounting records and obtain evidence to ensure that any significant transactions outside the normal course of business were valid and accounted for correctly. We will adopt data analytics techniques to review and test aspects of this significant risk. We will review the key accounting estimates, judgements and decisions made by management. This will include, for example, depreciation and amortisation rates, asset valuations, provisions and arrears.

### Revenue recognition

Under ISA (UK) 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements* there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the Board could adopt accounting policies or recognise income and expenditure transactions in such a way as to lead to a material misstatement in the reported financial position.

79. As part of our planning process, we have considered the nature of the revenue streams at the Board against the risk factors set out in ISA (UK) 240. We have identified that for Scottish Government funding the risk of revenue recognition can be rebutted due to a lack of incentive and opportunity to manipulate revenue of this nature. We have concluded, however, the risk of fraud in relation to revenue recognition is present in all other income streams.
80. We will review and evaluate each material revenue stream, including the controls over revenue accounting. We will conduct substantive testing on all material revenue streams to confirm revenue has been recognised appropriately and in line with accounting policies.

### Risk of fraud in the recognition of expenditure

As most public sector bodies are net spending bodies, the risk of fraud is more likely to occur in expenditure. There is an increased risk that expenditure may be misstated due to improper recognition of expenditure, resulting in a material misstatement in the financial statements.

81. In response to this risk we will evaluate the significant non-pay expenditure streams and review the controls in place over accounting for expenditure. (Payroll is subject to separate tailored testing). We will consider the Board's key areas of expenditure and obtain evidence that the expenditure was recorded in line with appropriate accounting policies and the policies have been applied consistently across the year. We will review accruals around the year end to consider if there is any indication of understatement of balances held through consideration of accounting estimates.

### Capital transactions (significant accounting estimate)

The Board holds a significant level of high value estate, with a net book value of land and buildings of £875.721 million at 31 March 2021. Significant additions are expected in 2021/22. The Board values its assets on a five-year cycle, with an element of the estate being subject to valuation each year. Indexation is applied to the element of the estate not being revaluated to take into account price movements.

There is a significant degree of subjectivity in the measurement and valuation of tangible assets. This subjectivity and the material nature of the Board's asset base represents an increased risk of misstatement in the financial statements.

82. We will ensure that assets, including capital additions, are recorded in line with the FReM and the Board's accounting policies, and have been accounted for appropriately. We will review asset valuations and ensure that the Board has completed a recent assessment for impairment across its estate.
83. We will consider the competence, capability and objectiveness of the external valuer in line with ISA 500 (UK). We will review the valuation report for 2021/22 and consider the assumptions used by the valuer against external sources of evidence. In addition, we will consider the

scope of the valuer's work and the information provided to the valuer for completeness.

#### PFI and related assets

NHS Lothian has a range of legacy facilities which were delivered through the Public-Private Partnerships (PPP) / Private Finance Initiatives (PFI), including The Royal Infirmary of Edinburgh, Midlothian Community Hospital, Ellens Glen and Findlay House. More recently, a Non-Profit Distributing Model (NPD) agreement has been entered into and commenced. The cumulative estimated base capital value of these agreements is in excess of £380 million.

Due to the complexity of accounting and the high value of the transactions, there is a risk that the Board's financial statements do not show the correct accounting entries and related commitments, and that the unitary payments in relation to these facilities are not correctly accounted for.

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84. We will review the Board's PPP / PFI accounting and the commitment disclosures against the requirements of the FReM, the Manual and against supporting contracts. We will also review relevant aspects of the transactions against the NHS Scotland Capital Accounting Manual.

**Provisions - CNORIS (significant accounting estimate)**

The Board in its financial statements includes provisions for legal obligations in respect of, for example, clinical and medical obligations and participation in CNORIS (Clinical Negligence and Other Risks Indemnity Scheme).

There is a significant degree of subjectivity in the measurement and valuation of provisions. This subjectivity represents an increased risk of misstatement in the financial statements.

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85. We will review the method and underlying assumptions used to carry out the valuation to ensure these are appropriate and accurately reflect the Board's obligation as at 31 March 2022. We will ensure that provisions, including CNORIS, are recorded in line with the FReM and the Board's accounting policies, and have been accounted for appropriately.
  86. We will consider the competence, capability and objectiveness of the external valuer in line with ISA 500 (UK). We will review the valuation report for 2021/22 and consider the assumptions used by the valuer against external sources of evidence. In addition, we will consider the scope of the valuer's work and the information provided to the valuer for completeness.

## Other risk factors

### Impact of COVID-19 on the financial statements

87. Further to the identification of significant audit risks, we also continue to monitor the impact COVID-19 could have on the financial statements. COVID-19 continues to present unprecedented challenges to the operation, financial management and governance of organisations, including public sector bodies.
88. We continue to monitor government and relevant announcements as they pertain to the audit and will adapt our audit approach as required.

### Key accounting estimates

89. Changes to ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures, which is applicable for accounting periods beginning on or after 15 December 2019, places increased regulatory requirements on the auditor in respect of the auditing of significant estimates at the planning and completion stages of the audit.
90. As part of the planning stages of the audit we identified all accounting estimates made by management and determined which of those are key to the overall financial statements. Consideration was given to fair value of property, plant and equipment, depreciation rates, provisions for clinical and medical negligence claims, pension provision, leases and accruals. Other than the fair value of property, plant and equipment and CNORIS provision, we have not determined the accounting estimates to be key. We will however revisit our assessment during the fieldwork and completion stages of our audit.

## The performance report, accountability report and other information

91. The HM Treasury Government Financial Reporting Manual 2021/22 sets out the content required within the annual report and accounts.
92. HM Treasury issued an addendum to the Government Financial Reporting Manual in 2019/20 and 2020/21 which permitted bodies to omit the performance analysis section of the Performance Report. This addendum does not apply in 2021/22 and full compliance with the Government Financial Reporting Manual is expected.
93. In addition to presenting our opinions over the financial statements our independent auditor's report will also present our opinion on the other aspects of the annual report and accounts:

### Other information

94. "Other information" in the annual report and accounts comprises any information other than the financial statements and our independent auditor's report thereon. We do not express any form of assurance conclusion on the "other information" except as specifically stated below.
95. We read all the financial and non-financial information in the annual report and accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent

material misstatements or inconsistencies we consider the implications for our independent auditor's report.

### The performance report

96. The performance report provides information on the entity, its main objectives and strategies and the principal risks that it faces. It contains two sections:

- an overview of the organisation, its purpose, the key risks to the achievement of its objectives and how it has performed during the year; and
- a detailed summary of how the entity measures its performance.

97. Our independent auditor's report will confirm whether in our opinion the performance report has been properly prepared and is consistent with the financial statements.

### The accountability report

98. The accountability report is required in order to meet key parliamentary accountability requirements. It has three sections:

- A corporate governance report (including a governance statement) explaining the composition and organisation of the entity's governance structures and how they support the achievement of the entity's objectives.
- A remuneration and staff report setting out staff numbers and costs as well as the entity's remuneration policy for directors and the remuneration awarded to directors.

- A parliamentary accountability report disclosing the regularity of expenditure and other parliamentary accountability requirements.

99. Our independent auditor's report will confirm whether in our opinion the governance statement and the audited part of the remuneration and staff report have been properly prepared and are consistent with the financial statements.

# Wider scope audit



## Wider scope audit

### Introduction

100. As described above, the Code of Audit Practice frames a significant part of our audit responsibilities in terms of four wider scope audit dimensions. As part of our annual audit we consider and report against these four dimensions:
- Financial sustainability
  - Financial management
  - Governance and transparency
  - Value for money.
101. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our work in prior years to develop an understanding of the Board's key priorities and risks, along with discussions with management and review of committee minutes and key strategy documents.
102. As outlined in the Scottish Public Finance Manual, accountable officers have a specific responsibility to ensure that arrangements are in place to secure best value in public services. Audit Scotland has requested that external auditors focus on the arrangements relating to the best value theme of fairness and equality. We will consider this in the context of our wider scope audit work and include commentary in our annual audit report as appropriate.
103. As summarised at Exhibit 4, we have identified one significant risk to the wider scope of our audit in relation to financial sustainability and two in relation to value for money.
104. At this stage, we have not identified any significant risks specifically in relation to financial management or governance and transparency. However, there is clear cross over between these areas and the significant risks identified.
105. Audit planning is a continuous process and we will report any other identified significant risks, as they relate to the four dimensions, in our annual audit report. Exhibit 5 summarises our audit work in respect of each dimension.

## Exhibit 4 – Wider scope significant risks

### Financial sustainability

In April 2021, the Board and Finance & Resource Committee considered a Financial Plan to support the Annual Operational Plan. The paper outlined a financial gap of £147 million in 2022/23, increasing to £178 million in 2025/26.

COVID-19 has had a fundamental impact on finances and financial planning in the shorter and medium term. The achievement of financial balance may be dependent on receiving full financial support from the Scottish Government to meet these costs.

The Board continues to face challenges in achieving savings targets, including recurrent savings, in amongst a challenging performance management landscape and unprecedented challenges of responding to COVID-19. The emerging and uncertain impact on the Board's finances and ability to deliver services in a sustainable manner remains a significant challenge and risk.

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106. In response to this risk we will consider how NHS Lothian balances the management of its medium and longer-term financial position with demand and performance targets, and the ongoing work to reflect the impact of COVID-19. Our work will include an assessment of progress made in developing financially sustainable operating plans that continue to support the delivery of the Board's statutory functions and strategic objectives.

### Value for money: Developments in relation to Royal Hospital for Children and Young People, Department of Clinical Neurosciences and Child and Adolescent Mental Health Services

There have been various reviews by a range of scrutiny bodies and functions into aspects of the new hospital. We summarised the key findings, outcomes and current status of these reviews in our previous annual reporting. The Cabinet Secretary commissioned a public inquiry into the issues experienced at the new Royal Hospital for Children and Young People in Edinburgh and the Queen Elizabeth University Hospital in Glasgow. This inquiry, which is being led by the Right Honourable Lord Brodie, is expected to continue throughout our 2021/22 audit.

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107. We will follow up on latest developments in relation to the Royal Hospital for Children and Young People, Department of Clinical Neurosciences and Child and Adolescent Mental Health Services and consider any further financial and governance implications.

### Value for money: Performance and outcomes

In our 2020/21 audit we noted that performance metrics (where available and comparable) showed a range of issues, including due to COVID-19.

Performance against targets has been an area of challenge for the Board in recent years, with underlying and ongoing financial and operational pressures. The Scottish Government placed NHS Lothian on Level 3 of its Performance Escalation Framework for general performance issues in 2019/20. There have also been recent adverse findings reported in relation to some specific elements of NHS Lothian's audiology and breast cancer screening arrangements.

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108. As part of our work on value for money, we will review the effectiveness of the Board's monitoring of performance against targets, consider progress against the recovery plan and review plans to help ensure continuous improvement in performance. We will also consider efficiency measures of Board performance, to help assess NHS Lothian's relative performance compared to other health boards and help understand and contextualise some of the performance metrics. We will also seek update on the health board's response in relation to the recent findings in relation to audiology and breast cancer screening provision.

## Exhibit 5 - Our audit approach to the wider scope audit dimensions



### Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the organisation’s planning processes support the future delivery of services.

Consideration	Our audit approach
<p>In 2020/21, we concluded that NHS Lothian has effective arrangements in place for financial planning and monitoring in the short term, but recognised that the Board continues to face significant challenges in achieving savings target and financial sustainability. The operating environment was already a significant challenge, now coupled with the unprecedented challenges of responding to and recovering from COVID-19 implications.</p> <p>The Financial Outlook &amp; Plan presented to the Board in April 2021 painted a stark picture over the next five years with substantial funding gaps beyond anything ever seen in NHS Lothian; £143million in 2022/23, increasing to £177million in 2025/26. These gaps represent 8-9% of full year recurring expenditure budgets, underlining the scale and challenge faced by the board as it looks to balance service performance with available resource.</p>	<p>During 2021/22, we will review and conclude on:</p> <ul style="list-style-type: none"> <li>• The ongoing development of financial planning and modelling to identify and address risks to financial sustainability; and</li> <li>• The appropriateness and effectiveness of arrangements in place to address any identified funding gaps.</li> </ul>



## Financial management

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

### Consideration

NHS Lothian met all its key financial targets in 2020/21, delivering an underspend against its Revenue Resource Limit and a breakeven position against its Capital Resource Limit. This was achieved despite the impact of COVID-19 (£111million on a net spend basis) through close working with Scottish Government and receipt of additional funding to cover the additional COVID-19 costs.

Based on a review of NHS Lothian’s financial performance, underlying position, financial reporting and achievement of savings targets at that time, we concluded that the Board had effective arrangements in place for financial management and the use of resources, although recognising the significant resource pressures faced.

The National Fraud Initiative (NFI) is a counter fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. The most recent NFI exercise commenced in January 2021, with matches to be investigated by 30 September 2021.

### Our audit approach

During our 2021/22 audit we will review, conclude and report on the following:

- The achievement of financial targets and effectiveness of financial performance reporting during 2021/22, including the impact of COVID-19;
- Whether the Board continues to have arrangements in place to ensure systems of internal control are operating effectively;
- Whether the Board can demonstrate the effectiveness of its budgetary control system in communicating accurate and timely financial performance;
- Whether the Board has established appropriate and effective arrangements for the prevention and detection of fraud and corruption, with particular focus on the impact of changes in the control environment, and fraud and corruption in the procurement function; and
- The Board’s participation and progress in the National Fraud Initiative.



## Governance and transparency

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

### Consideration

In previous years we have concluded that NHS Lothian has well developed governance arrangements in place, including an effective Assurance Framework for the Board and its main governance committees. NHS Lothian made minimal changes to governance arrangements as a result of COVID-19, seeking to maintain efficient and effective governance during the pandemic. However, Board meetings have not been held in public since April 2020 (with remote access made available to the public during the pandemic to support scrutiny and transparency).

### Our audit approach

As part of our work on governance and transparency work in 2021/22 we will review, conclude and report on:

- Whether the Board can demonstrate that the governance arrangements in place are appropriate and operating effectively;
- The transparency of decision-making, financial reporting and performance data; and
- Reasonableness and consistency of the governance statement in relation to other information gathered during our audit.



## Value for money

Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.

### Consideration

The board has acknowledged the dramatic impact that the COVID-19 pandemic has had on the performance of the organisation, exacerbating the extant challenges.

The remobilisation plan has been an area of focus and organisational effort throughout 2021/22, balancing COVID-19 and wider system pressures.

Transformational service redesign and the effective use of resources is essential, but the operational and financial context of the board exacerbates the difficulty in achieving this.

### Our audit approach

During 2021/22 we will review and look to report on:

- How NHS Lothian has balanced pandemic response and wider system remobilisation;
- How NHS Lothian has tackled and looked to optimise performance across the range of standards and metrics;
- The effectiveness of working with partners (including Integration Joint Boards, particularly in Edinburgh) to address significant delayed discharges; and
- The arrangements in place relating to the best value theme of fairness and equality.

# Audit outputs, timetables and fees



## Audit outputs, timetable and fees

### Audit outputs

The submission deadline for the annual accounts is provisional but is set to be consistent with the administrative deadline set by the Scottish Government. This is normally 30 June but has been provisionally set as 31 August for 2021/22.

The Auditor General is required to send the audited annual accounts to the Scottish Ministers who are then required to lay the accounts in the Scottish Parliament by 31 December 2022.

We have set out below target months which align to the Board's 2022 schedule of Audit and Risk Committee and Board meetings. We will aim to meet these scheduled meetings however this will be monitored during the audit process and may require to be revised to reflect emerging issues as a result of the pandemic and related circumstances.

Audit output	Description	Target month	Deadline for submission to Audit Scotland
External audit plan	This report sets out the scope of our audit for 2021/22.	February 2022	28 Feb 2022
Independent Auditor's Report	This report will contain our opinion on the financial statements, the audited part of the remuneration report, annual governance statement and management commentary.	June 2022 (August 2022 backstop)	31 August 2022
Annual Report to the Board and the Auditor General for Scotland	At the conclusion of each year's audit we issue an annual report setting out the nature and extent of our audit work for the year and summarise our opinions, conclusions and the significant issues arising from our work. This report pulls together all of our work under the Code of Audit Practice.	June 2022 (August 2022 backstop)	31 August 2022

109. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
110. The action plans within the reports will include prioritised recommendations, responsible officers and implementation dates. We will review progress against the action plans on a regular basis.

## Audit fee

111. Audit Scotland sets an expected audit fee that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for audit. The expected fee is reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.
112. As auditors we negotiate a fee with the audited body during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.
113. Auditors have scope to increase fees to reflect local circumstances by up to 10% for larger audits. In 2020/21, we agreed to set the audit fee at 4% above the expected fee level. For 2021/22, we propose reducing this by setting the audit fee at 3% (£8,355) above the expected fee level. This reflects the level of work we consider is required in response to the key audit risks identified, particularly the additional work required to reflect on the impact of COVID-19 on the

board's operating and control environment.

	2020/21	2021/22
Auditor remuneration	£245,685	£248,115
Pooled costs	£26,300	£26,890
Contribution to Audit Scotland costs	£12,060	£11,820
<b>Total fee</b>	<b>£284,045</b>	<b>£286,825</b>

114. We will take account of the risk exposure of the Board and the management assurances in place. We assume receipt of the draft working papers at the outset of our on-site final audit visit. If the draft accounts and papers are late, or agreed management assurances are unavailable, we reserve the right to charge an additional fee for additional audit work. An additional fee will be required in relation to any other significant exercises not within our planned audit activity.

## Audit timetable

115. The dates for our interim and final audits have been discussed via the Director of Finance, Deputy Director of Finance, and the Head of Financial Services.
116. We will produce a Financial Statements Strategy for 2021/22 to provide a framework for the detailed financial statements audit work. This will involve input from NHS Lothian's finance team to help agree

expectations, roles and responsibilities and ensure relevant detail is agreed as far in advance as possible to support an efficient and effective audit process. This will take full cognisance of changes being made to the NHS Accounts Manual.

117. A summary timetable, including audit outputs, is set out as follows:

<b>JAN 22</b>	●	Planning meeting to inform the 2021/22 audit
<b>FEB 22</b>	●	Presentation of External Audit Plan to the Audit and Risk Committee
<b>FEB 22</b>	●	Interim audit including a review of accounting systems and wider scope audit dimensions.
<b>MAY 22</b>	●	Accounts presented for audit and final audit visit begins
<b>JUN 22</b>	●	Annual audit report presented to Audit and Risk Committee
<b>JUN 22 (AUG 22 backstop)</b>	●	Annual Audit Report presented to the Board and submitted to the Auditor General for Scotland

# Appendices



## Appendix 1: Azets

Azets deliver accounting, tax, audit, advisory and business services, digitally and locally.

With over 6,500 advisers and specialists across our office network, we help people and organisations of all shapes and sizes save time, work smarter and achieve their goals. Our job is to give you the support you need so you can focus on what you do best.

We have been external auditors within the public sector for at least fifty years. We provide a comprehensive range of services to clients across the public sector, including NHS bodies, local authorities, central government bodies and FE colleges. We also provide services to charities, schools, as well as private and public limited companies.

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### Chris Brown

#### Audit Partner

[chris.brown@azets.co.uk](mailto:chris.brown@azets.co.uk)

Chris is the partner in charge of our audit of NHS Lothian. Chris has over 25 years' experience in NHS auditing and leads most of our external and internal audit appointments in the health sector, as well as a range of clients in the central government and education sectors. Chris is a recognised specialist in public sector governance and risk management and is always available to provide accounting and other advice to the Board.

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### David Eardley

#### Director

[david.eardley@azets.co.uk](mailto:david.eardley@azets.co.uk)

David is an experienced NHS external and internal audit director, with over a decade and a half in practice. He has led the management of our more complex and sizeable NHS external audit appointments. He is a member of the NHS Technical Accounting Group, is the engagement lead on the vast majority of his client portfolio, and has experience across the NHS, Local Authority, Central Government and Education sectors.

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## Nicola MacKenzie

### Manager

[nicola.mackenzie@azets.co.uk](mailto:nicola.mackenzie@azets.co.uk)

Nicola has over 7 years' public sector external audit experience, joining the firm in 2014 as an audit trainee. She has extensive experience of public sector audit across NHS, Local Authority, Central Government and Education sectors, and currently manages the audit of Edinburgh Integration Joint Board.



## Paul Kelly

### Business Technology and Consultancy Director

[paul.kelly@azets.co.uk](mailto:paul.kelly@azets.co.uk)

Paul leads the delivery of our computer audit services and has over 20 years' experience of delivering services such as network infrastructure and security reviews and determining compliance with the requirements of the information security standard, BS779.

## Appendix 2: Confirmation of independence

International Standard on Auditing (UK) 260 "Communication with those charged with governance" and the Revised Ethical Standard 2019 requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

### The provision of non-audit services

We have detailed in the table below the non-audit services provided, the threats to our independence as external auditor this presents and the safeguards we have put in place to mitigate these threats

Non-audit service	Type of threat	Safeguard
Audit of the abstract of receipts and payments of patients' private funds	Self-review	Work to be conducted under separate Audit Director, not involved in the audit of the NHS Lothian Board financial statements

The fee for this work in 2021/22 is expected to be around £7,300. In line with Audit Scotland planning guidance, approval is being obtained from the Azets ethics partner and Audit Scotland before commencing this work.

We confirm that we comply with FRC's Ethical Standard. In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Azets and the Board, its Board members and senior management that may reasonably be thought to bear on our objectivity and independence.

## Appendix 3: Statement of understanding

### Introduction

The purpose of this statement of understanding is to clarify the terms of our appointment and the key responsibilities of NHS Lothian (the Board) and Azets.

### Annual report and financial statements

We require the annual report and financial statements and supporting working papers for audit by the agreed date specified in the audit timetable. It is assumed that the relevant Board staff will have adequate time available to deal with audit queries and will be available up to the expected time of completion of the audit. We will issue a financial statements strategy in advance of our final audit visit which sets out our expectations in terms of audit deliverables. This document helps to ensure we can work together to deliver an efficient and effective audit.

### Fees

We base our agreed fee upon the assumption that all of the required information for the audit is available within the agreed timetable. If the information is not available within the timetable we reserve the right to charge a fee for the additional time spent by our staff. The fee will depend upon the level of skill and responsibility of the staff involved. The indicative financial statements strategy referred to above is a key means for us to clarify our expectations in terms of quality, quantity and extent of working papers and supporting documentation.

### Representations

As auditors we do not act as a substitute for the Board's responsibility to establish proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for and used economically, efficiently and effectively.

As part of our normal audit procedures, we will ask you to provide written confirmation of certain oral representations which we have received from the Board during the course of the audit on matters having a material effect on the financial statements. This will take place by means of a letter of representation, which will require to be signed by the Chief Executive.

### Internal audit

It is the responsibility of the Board to establish adequate internal audit arrangements. The audit fee is agreed on the basis that an effective internal audit function exists.

We will liaise with internal audit to ensure an efficient audit process.

### Fraud and irregularity

In order to discharge our responsibilities regarding fraud and irregularity we require any fraud or irregularity issues to be reported to us as they arise. In particular we require to be notified of all frauds which:

- Involve the misappropriation of theft of assets or cash which are facilitated by weaknesses in internal control
- Are over £5,000

We also require a historic record of instances of fraud or irregularity to be maintained and a summary to be made available to us after each year end.

## Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 impose an obligation on the Auditor General to inform the National Crime Agency (NCA) if he knows or suspects that any person has engaged in money laundering or terrorist financing.

We require the Board to notify us on a timely basis of any suspected instances of money laundering so that we can inform Audit Scotland who will determine the necessary course of action.

## Ethics

We are bound by the ethical guidelines of our professional body, the Institute of Chartered Accountants in England and Wales and the Code of Audit Practice.

## Service

If at any time you would like to discuss with us how our service to you could be improved or if you are dissatisfied with the

service you are receiving please let us know by contacting Chris Brown. If you are not satisfied, you should contact our Ethics Partner, Bernadette Higgins. In the event of your not being satisfied by our response, you may also wish to bring the matter to the attention of the Institute of Chartered Accountants in England and Wales.

We undertake to look at any complaint carefully and promptly and to do all we can to explain the position to you.

## Reports

During the course of the audit we will produce reports detailing the results and conclusions from our work.

Any recommendations arising from our audit work will be included in an action plan. Management are responsible for providing responses, including target dates for implementation and details of the responsible officer.

## Agreement of terms

We shall be grateful if the Audit Committee would consider and note this statement of understanding. If the contents are not in accordance with your understanding of our terms of appointment, please let us know.



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**Accounting | Tax | Audit | Advisory | Technology**

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