

NHS Lothian

Annual Audit Plan 2022/23



 AUDIT SCOTLAND

Prepared for NHS Lothian
March 2023

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2022/23 external audit of NHS Lothian. The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the annual report and accounts of NHS Lothian and the issue of an Independent Auditor's Report setting out our audit opinions on the financial statements, regularity and other statutory information including the Performance Report, Governance Statement and Remuneration and Staff Report
- consideration of arrangements in relation to wider scope areas: financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes
- consideration of Best Value arrangements.

Audit Appointment

2. We are pleased to be appointed as the external auditor of NHS Lothian for the period 2022/23 to 2026/27 inclusive. You can find a brief biography of your audit team at [Appendix 1](#).

3. In the first year of the audit appointment we invest time gaining an understanding of your business to support our identification and assessment of audit risks. While we use our initial assessment of risk to inform our planned audit approach, we keep it under review as the audit progresses. We will inform you of any significant changes in assessed risks and any resulting changes in our planned audit work.

4. The audit team will actively engage with you over the course of the audit to ensure our audit work continues to be focused on risk.

Adding value

5. We aim to add value to NHS Lothian by being constructive and forward looking, by attending committee and Board meetings and by recommending and encouraging good practice. In so doing, we will help NHS Lothian promote improved standards of governance, better management and decision making and more effective use of resources.

Respective responsibilities of the auditor and NHS Lothian

6. The [Code of Audit Practice 2021](#) sets out in detail the respective responsibilities of the auditor and NHS Lothian. Key responsibilities are summarised below.

Auditor responsibilities

7. Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice](#) (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

8. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual report and accounts. We also review and report on the wider scope arrangements in place at NHS Lothian. In doing this, we aim to support improvement and accountability.

NHS Lothian responsibilities

9. NHS Lothian is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

10. NHS Lothian has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to deliver their objectives.

Financial statements audit planning

Introduction

11. The annual report and accounts are an essential part of demonstrating NHS Lothian's stewardship of resources and its performance in the use of those resources.

12. We focus our work on the areas of highest risk. As part of our planning process, we assess any audit risks in the main financial systems relevant to the production of the financial statements.

Materiality

13. The concept of materiality is applied by auditors in planning and performing the audit and in evaluating the effect of any uncorrected misstatements on the financial statements. We are required to plan our audit to determine with reasonable confidence whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

Materiality levels for the 2022/23 audit

14. We assess materiality at different levels and the materiality values for NHS Lothian are set out in [Exhibit 1](#). Due to the impact of the group consolidation process we have calculated that the same materiality levels should apply for both.

Exhibit 1

2022/23 Materiality levels for NHS Lothian and its group

Materiality	NHS Lothian and its Group
<p>Planning materiality – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. Materiality has been set based on our assessment of the needs of the users of the financial statements and the nature of NHS Lothian's operations. For the year ended 31 March 2023 we have set our materiality at 1.5 per cent of gross expenditure (net of costs to the integration joint boards as these are notional) based on the audited financial statements for 2021/22.</p>	£40 million

Materiality	NHS Lothian and its Group
<p>Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this could indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 75 per cent of planning materiality.</p>	£30 million
<p>Reporting threshold (i.e. clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.</p>	£250,000

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

15. Our risk assessment draws on our cumulative knowledge of NHS Lothian, its major transaction streams, key systems of internal control and risk management processes. Also it is informed by our discussions with management, meetings with internal audit, attendance at committees and a review of supporting information.

16. Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and, where relevant, report them to those charged with governance.

17. Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 2](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

Exhibit 2**2022/23 Significant risks of material misstatement to the financial statements**

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p>1. Risk of material misstatement due to fraud caused by management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p> <p>This is presumed to be a significant risk in every audit.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable</p>	<ul style="list-style-type: none"> • Assess the design and implementation of controls over journal entry processing. • Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual journal activity. • Test journals at the year-end and post-closing entries and focus on significant risk areas. • Consider the need to test journal entries and other adjustments during the financial year. • Evaluate significant transactions outside the normal course of business. • Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Focused testing of accounting accruals and prepayments.
<p>2. Estimation in the valuation of land and buildings</p> <p>There is a significant degree of subjectivity in the valuation of land and buildings. Valuations are based on specialist and management assumptions and changes in these can result in material changes to valuations.</p>	<ul style="list-style-type: none"> • Competent valuers with significant experience and good understanding of the complexities of the sector and several NHS Scotland clients • Ongoing communication with the valuers throughout the year, with the support from the colleagues from Estates and Capital 	<ul style="list-style-type: none"> • Review the information provided from NHS Lothian to the external valuer to assess for completeness. • Review detailed working papers to support asset reviews and impairments. • Evaluate the competence, capabilities and objectivity of the professional valuer. • Obtain an understanding of management's involvement in the valuation process to assess if

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p>All non-current assets are revalued on a five-year rolling basis within indexation applied in interim years. NHS Lothian must ensure that its valuation process for land and buildings adequately reflects changes in the property market so that they are not materially misstated.</p>	<p>Planning, regarding the ongoing capital programme and developments to establish the best valuation approach to the Board property portfolio within any given year</p> <ul style="list-style-type: none"> Professional valuers have access to all sites and all supporting documentation 	<p>appropriate oversight has occurred.</p> <ul style="list-style-type: none"> Critically assess the approach NHS Lothian has adopted to assess the risk that assets not subject to valuation are materially misstated. Consider the robustness of that approach. Critically assess the adequacy of NHS Lothian's disclosures regarding the assumptions in relation to the valuation of land and buildings.

Source: Audit Scotland

18. As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements. We have rebutted this risk as funding from the Scottish Government and other NHS boards is clearly communicated and can be agreed to third party confirmations. The only remaining material revenue stream concerns integrated joint boards which is a notional amount and can be agreed to confirmation from both parties.

19. In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have rebutted this risk as the main expenditure streams of NHS Lothian mainly comprise of a high volume of relatively low value items. We consider there to be limited incentive and opportunity for the manipulation of expenditure recognition in the financial statements.

20. We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

Other areas of audit focus

21. As part of our assessment of audit risks, we have identified other areas where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider these to represent significant risks. We will keep these areas under review as our audit progresses.

22. The areas of specific audit focus are:

- **IFRS 16 Implementation:** IFRS 16 will be introduced in 2022/23. NHS Lothian will recognise their leases as right-of-use assets, with a corresponding lease liability in their statement of financial position. As disclosed in their 2021/22 financial statements, NHS Lothian assessed that this would result in an additional £109 million right-of-use assets with an associated lease liability of £109 million. We will engage with NHS Lothian at an early stage to review their proposed IFRS 16 opening balance adjustments and the presentation and disclosure that will be included in the 2022/23 accounts.
- **Estimation in the provision for clinical and medical negligence claims:** NHS Lothian holds provisions for estimated costs relating to clinical and medical negligence claims and participation in CNORIS (Clinical Negligence and Other Risks Indemnity Scheme). At 31 March 2022, the combined balance was £222.2 million. Reliance on the former is placed on the details provided by the NHS Scotland Central Legal Office (CLO) to quantify amounts provided. There is a significant amount of professional judgement applied by the CLO in arriving at these figures. As part of our work we shall consider the review of the CLO's methodology by Audit Scotland's Professional Support team.
- **Scottish Government repayment of Covid 19 funding from Edinburgh, East Lothian, West Lothian and Midlothian Integration Joint Boards:** In January 2023 the Scottish Government announced its intention to recover unspent Covid-19 funding in 2022/23. The level of funding to be recovered from across the four Integration Joint Boards totals £52.4 million. The exact accounting treatment is yet to be determined. As part of our audit, we will consider the implications for both NHS Lothian and the consolidated group accounts.

Group Consideration

23. As group auditors, we are required under International Standard on Auditing (ISA) (UK) 600: *Audits of group financial statements (including the work of component auditors)* to obtain sufficient appropriate audit evidence on which to base our audit opinion on the group financial statements.

24. NHS Lothian has a group which comprises component entities, including subsidiaries and joint ventures. The audits of the financial information of some of the components are performed by other auditors. We plan to place reliance on the work of the component auditors.

25. We will obtain sufficient appropriate audit evidence in relation to the consolidation process and the financial information of the components on which to base our group audit opinion.

Wider Scope and Best Value

Introduction

26. The [Code of Audit Practice](#) sets out the four areas that frame the wider scope of public sector audit and requires auditors to consider the adequacy of the arrangements in place.

Wider scope audit focus

27. Our planned work on our wider scope responsibilities is risk based and proportionate. In addition to local risks we consider challenges which are impacting the public sector as a whole. In summary, the four wider scope areas cover the following:

- **Financial management** – concerned with financial capacity, sound budgetary processes and the operation of the control environment. We will consider the arrangements to secure sound financial management including the strength of the financial management culture and the achievement of recurring savings. We will also conclude on arrangements to prevent and detect fraud, error and other irregularities.
- **Financial sustainability** – as auditors, we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on financial sustainability in the medium term (two to five years) and longer term (longer than five years).
- **Vision, leadership and governance** – we conclude on the arrangements in place to deliver the vision, strategy and priorities adopted by NHS Lothian. We also consider the effectiveness of the governance arrangements to support delivery.
- **Use of resources to improve outcomes** – we will consider how the NHS Lothian demonstrates economy, efficiency and effectiveness through the use of financial and other resources. This will include consideration of NHS Lothian's contribution to the Scottish Hospitals Inquiry and responses to any resultant recommendations. We will also monitor performance on metrics such as waiting times.
- **Climate Change** - tackling climate change is one of the greatest global challenges and the Scottish Parliament has set a legally binding target of becoming net zero by 2045. We will gather information on NHS Lothian's arrangements for responding to climate change including the development of strategies and the monitoring and reporting of progress against targets for reducing emissions.

- **Cyber Security** - There continues to be a significant risk of cyber-attacks to public bodies and a number of recent incidents have demonstrated the significant impact they can have on both the finances and operation of an organisation. In 2022/23, we will consider NHS Lothian's arrangements for managing and mitigating cyber security risks.

Duty of Best Value

28. [Ministerial Guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) explain that accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. We will be carrying out a high-level review to confirm that such arrangements are in place within NHS Lothian.

Reporting arrangements, timetable, and audit fee

Reporting arrangements

29. Audit reporting is the visible output for the annual audit. All audit outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

30. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officers to confirm factual accuracy.

31. We will provide an independent auditor's report to NHS Lothian, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the annual report and accounts. We will provide NHS Lothian and the Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

32. [Exhibit 3](#) outlines the target dates for our audit outputs and we aim to issue the independent auditor's report by the statutory deadline of 30 June 2023.

Exhibit 3 2022/23 Audit outputs

Audit Output	Target date	Audit and Risk Committee Date
Annual Audit Plan	31/03/2023	17/04/2023
Independent Auditor's Report	23/06/2023*	19/06/2023
Annual Audit Report	23/06/2023*	19/06/2023

Source: Audit Scotland

* These dates represent when the independent auditor's report will be signed, and the final annual audit report issued. We will provide copies to those charged with governance in advance of the June committee to enable them to be considered.



Timetable

33. To support an efficient audit, it is critical that the timetable for producing the annual report and accounts for audit is achieved. We have included a proposed timetable for the audit at [Exhibit 4](#).

34. The Covid-19 pandemic has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. We are identifying ways to work more efficiently to expedite the 2022/23 audits whilst at the same time maintaining high standards of quality.

35. We intend to take a hybrid approach to the 2022/23 audit with a blend of onsite and remote working. We will continue to work closely with management to identify the most efficient approach as appropriate and will keep timeframes and logistics for the completion of the audit under review. Progress will be discussed with management and finance officers over the course of the audit.

Exhibit 4 Proposed annual report and accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual report and accounts by those charged with governance	9 May 2023
Receipt of the unaudited annual report and accounts with supporting working papers package.	9 May 2023
Issue draft annual audit report for clearance discussion	31 May 2023
Latest date for final clearance meeting with the Director of Finance	5 June 2023
Agreement of audited and unsigned annual report and accounts	9 June 2023
Issue of annual audit report, letter of representation and proposed independent auditor's report to those charged with governance	12 June 2023
Consideration of audited annual report and accounts and audit reporting by those charged with governance	19 June 2023
Independent auditor's report signed	23 June 2023

Source: Audit Scotland

Audit fee

36. Following the audit appointment process there has been an increase in our audit fees for 2022/23. This reflects the current audit market and the rising costs of increased regulatory expectations and risks placed on audit and its quality, as well as a widening in the scope of work audit must cover.

37. The audit fee for the 2022/23 audit of NHS Lothian has been set at the baseline level of £339,080 (£286,825 in 2021/22). This audit fee assumes that NHS Lothian has effective governance arrangements and will prepare comprehensive and accurate annual accounts in line with the agreed timetable for the audit. The audit fee assumes there will be no major change in respect of the scope of the audit during the year and where our audit cannot proceed as planned, a supplementary fee may be levied.

Other matters

Internal audit

38. It is the responsibility of NHS Lothian to establish adequate internal audit arrangements. We will review the internal audit plan and the results of internal audit's work.

39. From our initial review of the internal audit plans, we do not plan to place formal reliance on internal audit's work for our financial statements' responsibilities. We will, however, review all internal audit reports and assess the impact of the findings on our wider scope audit responsibilities. In particular we shall consider the findings from the reviews of core financial controls; information security; procurement; statutory and mandatory training; whistleblowing and pharmacy.

Independence and objectivity

40. Auditors appointed by the Auditor General for Scotland or Accounts Commission must comply with the [Code of Audit Practice](#) and relevant supporting guidance. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors.

41. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual '*fit and proper*' declaration for all members of staff. The arrangements are overseen by the Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

42. The appointed auditor for NHS Lothian is Carole Grant, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of NHS Lothian.

Audit Quality

43. Quality is at the core of public audit in Scotland and is the foundation for building consistency and confidence across all audit work. High quality audits provide assurance, add value and can support public bodies to achieve their objectives.

44. Until 2021/22, the applicable audit quality standard was International Standard on Quality Control 1 (ISQC (UK) 1). This set out an audit practice's responsibilities for its system of quality control for audits.

45. ISQC(UK) 1 has been replaced by two new audit quality standards: Internal Standards on Quality Management (ISQM (UK) 1) applicable from 15 December 2022 and (ISQM(UK) 2) effective for the 2023/24 audits. Work is underway at Audit Scotland to meet the requirements of these quality standards.

46. Audit Scotland is committed to delivering high quality audits. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the [Code of Audit Practice](#) (and supplementary guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of England and Wales (ICAEW) have been commissioned to carry out external quality reviews.

47. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time, and this may be directed to the appointed auditor.

Appendix 1. Your audit team

The audit team involved in the audit of NHSL have significant experience in public sector audit.

Carole Grant

Audit Director

cgrant@audit-scotland.gov.uk

Carole has over 20 years of public sector auditing experience across the breadth of the public sector on both financial and performance audits.

Stuart Nugent

Senior Audit Manager

snugent@audit.scotland.gov.uk

Stuart has over 20 years of public sector audit experience and has delivered external audit services to a range of bodies including local authorities, health boards and central government bodies.

Alison Turner

Senior Audit Manager

alturner@audit.scotland.gov.uk

Alison has considerable experience in planning and delivering audits. Alison will manage the team along with Ross and work alongside Stuart and Carole to deliver the audit.

Ross Hubert

Senior Auditor

rhubert@audit-scotland.gov.uk

Ross has considerable experience in planning and delivering audits. Ross will manage the team along with Alison and work alongside Stuart and Carole to deliver the audit.

Grace Symes

Auditor

gsymes@audit-scotland.gov.uk

Grace has worked on a range of audits covering health and local government.

Kirsty McCartney

Trainee Auditor

kmccartney@audit-scotland.gov.uk

Kirsty is a professional trainee and is currently studying for her ICAS qualification. Kirsty has worked on central government audits.

Calum Finlayson-Crawshaw
Trainee Auditor
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Calum is a professional trainee and is currently studying for his ICAS qualification. Calum has worked on health and central government audits.

The local audit team is supported by a specialist technical accounting team, all of whom have significant experience of public bodies and work with accounting regulatory bodies.

Where possible and appropriate, we use our data analytics team to enable us to capture whole populations of your financial data. This analysis allows us to identify specific exceptions and anomalies within populations to enhance the focus of audit testing and support efficiency.

NHS Lothian

Annual Audit Plan 2022/23

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

www.audit-scotland.gov.uk/accessibility

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