



## NHS Lothian

# 2021/22 Annual Audit Report to the Board and the Auditor General for Scotland

July 2022



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# Key messages



This report concludes our audit of NHS Lothian for 2021/22.

This section summarises the key findings and conclusions from our audit.



## Financial statements audit

<b>Audit opinion</b>	<p>Our independent auditor's report:</p> <ul style="list-style-type: none"><li>• An unqualified opinion on the financial statements;</li><li>• An unqualified opinion on regularity; and</li><li>• An unqualified opinion on other prescribed matters.</li></ul>
<b>Key findings on audit risks and other matters</b>	<p>We have obtained adequate evidence in relation to the key audit risks identified in our audit plan.</p> <p>We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the financial statements.</p> <p>The accounting policies used to prepare the financial statements are in line with the NHS Accounts Manual and are considered appropriate.</p> <p>All material disclosures required by relevant legislation and applicable accounting standards have been made.</p> <p>The Board had effective administrative processes in place to prepare the annual report and accounts and the required supporting working papers.</p>
<b>Audit adjustments</b>	<p>We identified no material adjustments to the financial statements. We identified eight immaterial differences, six of which have been adjusted for in the financial statements. We also identified disclosure and presentational adjustments which have been reflected in the final set of financial statements, most significantly in relation to property, plant and equipment additions and the remuneration report.</p>
<b>Accounting systems and internal controls</b>	<p>We have applied a risk-based methodology to the audit. This approach requires us to document, evaluate and assess the Board's processes and internal controls relating to the financial reporting process.</p> <p>Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we have included these in this report. No material weaknesses or significant deficiencies were noted.</p>

## Wider scope audit



### Financial Sustainability

#### Auditor judgement



The Board will continue to face challenges over the next few years in achieving a balanced financial position due to a mix of COVID-19 and more general pressures on the health service. The Board's ability to develop and maintain its core services and new initiatives in a sustainable manner remains at significant risk from 2022/23 and beyond and requires continuing careful management and oversight.



### Financial Management

#### Auditor judgement



All three key financial targets for the year were met. The Board has effective arrangements in place for financial management and the use of resources, albeit it continues to face significant resource pressures.



### Governance & Transparency

#### Auditor judgement



Governance arrangements continue to be satisfactory and appropriate. The Board made minimal changes to its governance arrangements as a result of COVID-19, meeting frequently during 2021/22 to provide effective scrutiny, challenge and oversight and receive assurance on the management of risk.



### Value for Money

#### Auditor judgement



Whilst an established and appropriate performance management framework is in place at NHS Lothian, the pandemic has exacerbated what were already tough core service delivery challenges. Making progress to tackle the wide range of performance metrics in the medium term has never been more demanding.

## Definition

Our wider scope audit involves consideration of the Board's arrangements as they relate to financial sustainability, financial management, governance and transparency, and value for money. We have used the following grading to provide an overall assessment of the arrangements in place as they relate to the four dimensions.



# Introduction



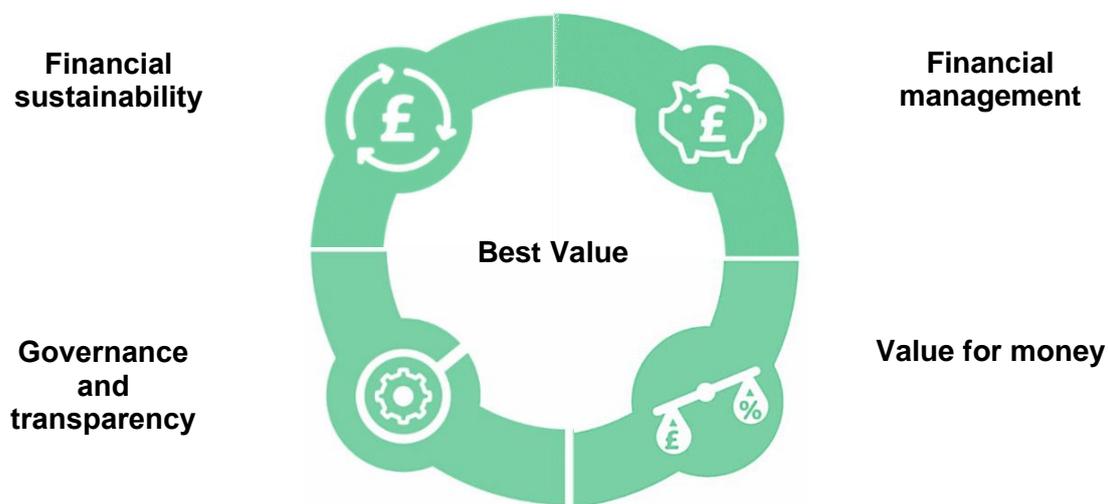
We carried out our audit in accordance with Audit Scotland's Code of Audit Practice and maintained auditor independence



## Scope

1. We outlined the scope of our audit in our External Audit Plan, which we presented to the Audit and Risk Committee in February 2022. The core elements of our work include:
  - an audit of the 2021/22 annual report and accounts and related matters;
  - consideration of the wider dimensions of public audit work, as set out in Exhibit 1;
  - monitoring the Board's participation in the National Fraud Initiative (NFI); and
  - any other work requested by Audit Scotland.

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



## Responsibilities

2. The Board is responsible for preparing an annual report and accounts which show a true and fair view and for implementing appropriate internal control systems. The weaknesses or risks identified in this report are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit 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.
3. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting, on the basis of the content of this report as this report was not prepared for, nor intended for, any other purpose.
4. The respective responsibilities of the Board and the auditor are detailed in Appendix 1.
5. Our thanks go to all management and staff for their co-operation and assistance during our audit.

## Auditor independence

6. International Standards on Auditing in the UK (ISAs (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 complied with the Financial Reporting Council's (FRC) Ethical Standard. In our professional judgement, we remained independent and our objectivity has not been compromised in any way.
8. We set out in Appendix 1 our assessment and confirmation of independence.

## 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)

## 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.

# Financial statements audit



The Board's annual report and accounts are a principal means of accounting for the stewardship of its resources and its performance in the use of those resources.



## Overall conclusion

12. The annual report and accounts were considered by the Audit and Risk Committee on 20 June 2022 and approved by the Board on 22 June

2022. Our independent auditor's report is unqualified.

## Our audit opinions

Opinion	Basis for opinion	Conclusions
Financial statements	<p>We conduct our audit in accordance with applicable law and International Standards on Auditing.</p> <p>Our findings / conclusions to inform our opinion are set out in this section of our annual report.</p>	We have issued unqualified audit opinions.
Going concern basis of accounting	<p>In the public sector when assessing whether the going concern basis of accounting is appropriate, the anticipated provision of services is more relevant to the assessment than the continued existence of a particular public body.</p> <p>We therefore assess whether there are plans to discontinue or privatise the Board's functions.</p> <p>Our wider scope audit work considers the financial sustainability of the Board.</p>	<p>As at 31 March 2022, the board reported a net asset position of £213.136million. In the board's opinion, the organisation will be able to continue for the foreseeable future.</p> <p>We reviewed the financial forecasts for 2022/23. Our understanding of the legislative framework and activities undertaken provides us with sufficient assurance that the board's functions will continue for at least 12 months from the signing date. Our audit opinion is unqualified in this respect.</p>

Opinion	Basis for opinion	Conclusions
<p>Regularity</p>	<p>We plan and perform our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts.</p>	<p>We did not identify any instances of irregular activity.</p> <p>In our opinion, in all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers.</p>
<p>Matters prescribed by the Auditor General for Scotland:</p> <ul style="list-style-type: none"> <li>• Remuneration and Staff Report</li> <li>• Performance Report</li> <li>• Governance Statement</li> </ul>	<p>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 or inconsistent with the knowledge acquired by us during the audit.</p> <p>We plan and perform audit procedures to gain assurance that the statutory other information has been prepared in accordance with directions from Scottish Ministers.</p>	<p>The annual report contains no material misstatements or inconsistencies with the financial statements.</p> <p>The audited part of the remuneration and staff report has been prepared in accordance with the National Health Service (Scotland) Act 1978 and directions from Scottish Ministers.</p> <p>The information given in the performance report has been prepared in accordance with directions from Scottish Ministers and is consistent with the financial statements.</p> <p>The information given in the Governance Statement has been prepared in accordance with the National Health Service (Scotland) Act 1978 and directions from Scottish Ministers and is consistent with the financial statements.</p>

Opinion	Basis for opinion	Conclusions
Matters reported by exception	<p>We are required to report on whether:</p> <ul style="list-style-type: none"> <li>adequate accounting records have not been kept; or</li> <li>the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or</li> <li>we have not received all the information and explanations we require for our audit; or</li> <li>there has been a failure to achieve a prescribed financial objective.</li> </ul>	We have no matters to report.

## Risk based audit approach

- 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. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.
- At the planning stage we identified the significant risks that had the greatest effect on our audit. Audit procedures were then designed to mitigate these risks.
- In our audit, we test and examine information using sampling and other audit techniques to the extent we consider necessary to provide a

reasonable basis for us to draw conclusions. We obtain evidence through performing a review of the significant accounting systems, substantive procedures and detailed analytical procedures.

## Significant risk areas

- Significant risks are defined by professional standards as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, we consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.
- The significant risk areas described in the table below are those that had the greatest effect on our audit strategy,

the allocation of resources in the audit and directing the efforts of the audit team. Our audit procedures relating to these matters were designed in the context of our audit of the annual report and accounts as a whole, and

not to express an opinion on individual accounts or disclosures. Our opinion on the annual report and accounts is not modified with respect to any of the risks described below.

## Significant risk areas

### 1. Management override

#### Significant risk description

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*.

#### How the scope of our audit responded to the significant risk

##### Key judgement

There is the potential for management to use their judgement to influence the financial statements as well as the potential to override controls for specific transactions.

##### Audit procedures

- Review of the board's accounting records and audit testing on transactions.
- Adoption of data analytics techniques in carrying out testing.
- Review of judgements and assumptions made in determining accounting estimates as set out in the financial statements to determine whether they are indicative of potential bias. This included a retrospective review of the prior year estimates against the current year estimates.

#### Key observations

We have not identified any indication of management override leading to material misstatement or significant concern. We reviewed the board's accounting records and obtained evidence to ensure that transactions outside normal processes were valid and accounted for correctly.

We also reviewed management estimates and the journal entries processed in the period and around the year end. To date, we have not identified any areas of bias in key judgements made by management or judgements which were inconsistent with prior years.

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We noted that timely review of suspense and control accounts has not been clearly evidenced. Whilst we consider these accounts to present a higher risk of containing and concealing inappropriate journal entries, we do not deem this to be material to the financial statements and have raised a management action point (Appendix 4).

**Action plan point 1**

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## 2. Revenue recognition

### Significant risk description

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.

### How the scope of our audit responded to the significant risk

#### Key judgements

Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of income around the year end.

#### Audit procedures

- Evaluate each material revenue stream and review controls over revenue accounting.
- Audit testing over the revenue recognition policy to ensure it is appropriate and applied consistently throughout the year.
- Review deferred income around the year end to consider if there is any indication of misstatement of balances held through consideration of accounting estimates.

### Key observations

At the planning stage of our audit cycle, we rebutted the risk of revenue recognition in Scottish Government funding due to a lack of incentive and opportunity to manipulate revenue of this nature. However, we assumed this risk is present in all other income streams.

To inform our audit conclusions, we evaluated the type and extent of revenue transactions and reviewed the controls in place over revenue accounting. We carried out substantive testing to confirm that the board's revenue recognition policy is appropriate and has been applied consistently throughout the year.

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We gained reasonable and appropriate assurance that this area is free from material misstatement, however we noted two adjusted differences (Appendix 3) in relation to (i) the understatement of profit on disposal of the Royal Hospital for Sick Children, and (ii) the reversal of an incorrect journal posted against both accrued and deferred income, with no impact on the net asset position.

In 2020/21 we raised a management action point to revise the board's approach to how research and development income which is pertinent to commercial contracts is recognised in line with IFRS 15. The board has undertaken significant work on the recognition of commercial research and development income in 2021/22 and we are satisfied that action has been appropriately addressed.

### 3. Expenditure recognition

#### Significant risk description

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

#### How the scope of our audit responded to the significant risk

##### Key judgements

Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of accruals around the year end.

##### Audit procedures

- Evaluate the significant non-pay expenditure streams and review the controls in place over accounting for expenditure. (Payroll is subject to separate tailored testing).
- Consider the board's key areas of expenditure and obtain evidence that expenditure is recorded in line with appropriate accounting policies and the policies have been applied consistently across the year.
- Review accruals around the year end to consider if there is any indication of understatement of balances held through consideration of accounting estimates.

#### Key observations

We evaluated each type of expenditure transaction and documented our conclusions. We gained reasonable assurance over the completeness and occurrence of expenditure and are satisfied that expenditure is fairly stated in the financial statements. To inform our conclusion we carried out testing to confirm that the board's policy for

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recognising expenditure is appropriate and was applied consistently throughout the year.

We noted a small number of sales invoices that had been incorrectly miscoded to expenditure. We do not deem this to be material to the financial statements. A management action has been raised (Appendix 4) and an adjusted misstatement noted (Appendix 3).

***Action Plan Point 2***

**Classification of expenditure**

The board incurred £4.5 million of spend in relation to lifecycle maintenance on the Royal Infirmary of Edinburgh. Historically, as the asset was initially held off-balance sheet, this spend has been classified as the payment of a capital grant for which the board receives non-core RRL funding. However, as the asset is now held on the balance sheet, this spend should be classified as core expenditure and covered by core RRL funding.

We do not deem this to be material to the financial statements as the board continues to meet its overall RRL target. However, we have raised a management action point to ensure the accounting and funding implications are addressed in 2022/23 (Appendix 4).

***Action Plan Point 3***

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**4. Capital transactions**

**Significant risk description**

The board holds a significant level of high value estate and 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 revalued, to reflect 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.

**How the scope of our audit responded to the significant risk**

**Key judgements**

Boards are required to ensure properties are held at a carrying amount that does not differ materially from the current value at 31 March, including taking cognisance of changes in the asset base.

**Audit procedures**

- Review the reasonableness of assumptions used in determining the fair value of assets at 31 March 2022.
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- Consider the accuracy and completeness of disclosures in the annual accounts.
  - Consider the competence, capability and objectiveness of the external valuer in line with ISA (UK) 500 *Audit Evidence*.
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## Key observations

### Additions and completed assets

During 2021/22, the board reported capital additions of £48 million and completions of £72.651 million. We reviewed these capital transactions and gained assurance that they have been accounted for in line with the Government Financial Reporting Manual ('the FReM'), the NHS Capital Accounting Manual and the board's accounting policies. We gained reasonable assurance that additions and completions are free from material misstatement, however we noted an unadjusted difference of £4.6 million in relation to intangible assets capitalised as property, plant and equipment (Appendix 3).

In 2019/20 and 2020/21, we identified immaterial balances within assets under construction that should have been recognised as completed assets under the appropriate asset category. We are satisfied that assets under construction have been subject to sufficient review in 2021/22 and have not identified any indication of completed assets within assets under construction as at 31 March 2022.

### Classification of spend

In 2021/22, the board identified £22.5 million of balances within assets under construction requiring reclassification from capital to revenue spend. In addition, £11 million of expenditure recorded within assets under construction had been reclassified as capital grants paid to other bodies as the spend related to assets not held by the board.

We reviewed the balances written off to revenue. With the exception of an impairment of £13 million which has been adjusted for (Appendix 3), we are satisfied that the accounting treatment is appropriate. We considered the classification of spend between capital and revenue throughout our audit testing and have not identified any further indication of incorrect classification.

The significant scale of this write off to revenue and capital grants is due to numerous large projects being completed in-year and an exercise undertaken to review brought forward balances within assets under construction. The board's current practice is to undertake a detailed review of spend once a project is complete. However, we recommend that management undertake sufficiently regular reviews during the lifetime of each project to ensure that capitalised spend is not materially misstated at the year end and the

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reasons for write-offs are fully understood and addressed as appropriate. (Appendix 4).

**Action plan point 4**

**Valuation**

We gained assurance that the carrying value of the board's estate in the financial statements is in line with the external valuer's report (Avison Young). In accordance with ISA (UK) 500 *Audit Evidence*, we considered the competence, capability and objectivity of the professional valuer and did not identify any items which gave us cause for concern over the suitability of the valuer. We confirmed that the basis of valuation for assets is appropriate based on their usage and reviewed the reasonableness of valuation assumptions applied. Overall, the valuation movements were in line with our expectations.

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**5. PFI and related assets**

**Significant risk description**

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, Ellen's 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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**How the scope of our audit responded to the significant risk**

**Key judgements**

Boards are required to ensure PFI and related assets are held at a carrying amount that does not differ materially from the current value at 31 March, alongside appropriate additional disclosures.

**Audit procedures**

- Review and update understanding of the board's range of such agreements.
- Consider compliance with the requirements of the FReM and NHS Manual for Accounts.

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**Key observations**

**PFI accounting**

We reviewed the board's PPP/PFI/NPD accounting and related commitment disclosures against the requirements of the FReM, the Manual and against the supporting contracts. We also reviewed relevant aspects of the transactions against the NHS Scotland Capital Accounting Manual. A management action point (Appendix 4) was raised on the treatment of lifecycle maintenance detailed above, but no further exceptions were identified in relation to PPP/PFI accounting.

**PFI contract expiry**

A number of NHS Lothian's PFI contracts are now approaching the end of their term. There are specific risks in the expiry phase of PFI contracts, for example around the quality of assets on hand-back and the availability of data and information to manage assets and services post PFI expiry. In addition, there can be relationship pressures as PFI investors look to optimise returns prior to expiry. These risks will need to be carefully managed to avoid disruption to facilities and services.

In view of the complexity of many PFI contracts and the length of time since they were initiated, the board will need to give early consideration of the nature and level of resource required to manage the contract expiry process. The Scottish Futures Trust and the UK government's Infrastructure and Projects Authority have issued guidance which suggests that, for complex facilities such as acute hospitals, preparation for handback needs to commence between eight and ten years before the end of the contract. The guidance also notes that the expiry process will require more and different senior management support than is currently being provided to the PFI project.

The board's risk register contains references to PFI asset handover but does not include a specific risk and mitigating actions regarding PFI contract expiry. We recommend the board considers including such a risk on the risk register.

***Action plan point 5***

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## 6. Provisions (significant accounting estimate)

### Significant risk description

The financial statements include provisions for legal obligations, for example in respect of 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.

### How the scope of our audit responded to the significant risk

#### Key judgements

Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of provisions around the year end.

#### Audit procedures

- Review management's estimate of the provision and related disclosures
- Consider compliance with the requirements of the FReM and NHS Manual for Accounts.
- Consider the competence, capability and objectiveness of the management expert in line with ISA (UK) 500 *Audit Evidence*.

### Key observations

We are satisfied that the amount recognised as a provision appropriately reflects the amounts notified by the Central Legal Office (CLO). We reviewed management's estimation of the provision and related disclosures, and are satisfied that these comply with the requirements of the FReM and NHS Manual for Accounts.

Audit Scotland undertake an annual review of the work carried out by the CLO to establish the extent to which the information they provide as a management expert can be used as audit evidence under ISA (UK) 500 and evaluate the appropriateness of the methodology adopted by Scottish Government to estimate the total national obligation. Audit Scotland concluded that the CLO is objective, has sufficient expertise and the capability, time and resource to deliver reliable information. Their review did not identify any issues in the methodology used by Scottish Government. However, Audit Scotland's review noted that the national obligation was overstated by £8.696 million due to manual error, with NHS Lothian's share revised downward by £1.383 million (Appendix 3). Scottish Government adjusted the funding accordingly and NHS Lothian has appropriately reflected this in the financial statements.

## Other risk factors

### Other impacts of COVID-19 on the annual accounts

18. COVID-19 continues to present unprecedented challenges to the operation, financial management and governance of organisations, including public sector bodies. In response to

the pandemic we identified potential areas of increased risk of material misstatement to the financial statements and/or our audit opinion. Our conclusions are set out in the table below.

Area considered	Description	Conclusion
Access to audit evidence	Our audit this year has again been carried out remotely. As a consequence, we identified a risk that access to and provision of sufficient, appropriate audit evidence in support of our audit opinion may be impacted by the inherent nature of carrying out our audit remotely.	<p>We employed a greater use of technology to examine evidence, but only where we assessed both the sufficiency and appropriateness of the audit evidence produced.</p> <p>We stayed in close contact with board management right up until the point of accounts signing, to ensure all relevant issues were satisfactorily addressed.</p>
Timescales / administrative processes	In Scotland, the administrative deadline for the submission of audited accounts of health boards and agencies is usually 30 June but this has been extended by two months to 31 August. The legislative deadline for laying accounts in the Scottish Parliament remains 31 December.	<p>The board decided to continue with the original timescales (i.e. 30 June).</p> <p>We worked closely with management throughout the audit and collectively we achieved the planned 30 June timescale for signing the accounts and submitting them to Scottish Government.</p>

## Estimates and judgements

19. We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the financial statements.

20. As part of the planning and fieldwork stages of the audit we identified all accounting estimates made by management and determined which of those are key to the overall financial statements. Particular 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 property, plant and equipment and CNORIS provision, we did not determine the accounting estimates to be significant. We revisited our assessment during the audit and confirmed it remained appropriate.

21. Our audit work consisted of reviewing these key areas for any indication of bias and assessing whether the judgements used by management are reasonable. We have summarised our assessment of this below, categorising each area as either Prudent, Balanced or Optimistic.

## Estimates and judgements

### Asset valuations

Balanced

Asset valuations are carried out by external valuers on an annual basis. We evaluated the competence, objectivity and capability of management experts in line with the requirements of ISA (UK) 500 and concluded that use of the experts was appropriate. We confirmed that the basis of valuation for assets is appropriate based on their usage and reviewed the reasonableness of valuation assumptions applied. Overall, the valuation movements were in line with our expectations.

### Provisions

Balanced

Significant estimates were made in relation to the valuation of liabilities related to the board's membership of the Clinical Negligence and Other Risks Indemnity Scheme (CNORIS). These estimates were informed by advice from qualified, independent experts.

We evaluated the competence, objectivity and capability of management experts in line with the requirements of ISA (UK) 500 and concluded that use of the experts was appropriate.

## Materiality

22. 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 and is affected by our assessment of the risk profile of the organisation and the needs of users. We review our assessment of materiality throughout the audit.

23. Whilst our audit procedures are designed to identify misstatements which are material to our audit opinion, we also report to the Board and management any uncorrected misstatements of lower value errors to the extent that our audit identifies these.

24. Our initial assessment of materiality for the group and the board's financial statements was £30,000,000. On receipt of the unaudited annual accounts, we reassessed materiality and updated it to £33,000,000. We consider that our updated assessment has remained appropriate throughout the audit.

## Materiality

### Overall materiality

£33,000,000



100%

Accounts materially misstated where total errors exceed this value

### Performance materiality

£21,450,000



75%

Work performed to capture individual errors at this level

### Trivial threshold

£250,000



De minimis

All errors greater than this level are reported

### Overall materiality

Our assessment is made with reference to 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 annual accounts when assessing financial performance.

Our assessment of materiality equated to approximately 1.5% of the board's RRL as disclosed in the 2021/22 unaudited annual accounts.

We set materiality for both the Group and the board at the same level given our assessment and approach to the group audit. We concluded that none of the five subsidiaries are significant to the overall group.

We applied a lower level of materiality to the audit of the Remuneration Report, which was set at £5,000.

### Performance materiality

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 groups 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.

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.

**Trivial threshold**

Clearly trivial matters are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

## Group audit

25. The board prepares its annual report and accounts on a group basis. The group consists of the board, the Lothian Health Board Endowment Fund (since renamed NHS Lothian Charity) and the four integration joint boards (Edinburgh, West Lothian, East Lothian and Midlothian).
26. As group auditors under ISA (UK) 600 we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and regarding 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
East Lothian Integration Joint Board	No	Analytical	Desktop review
West Lothian Integration Joint Board	No	Analytical	Desktop review
Midlothian Integration Joint Board	No	Analytical	Desktop review

**Comprehensive** The component is of such significance to the group as a whole that an audit of the component financial statements is required for group reporting purposes.

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

28. The Endowment Fund is fully consolidated. We did not consider the Endowment Fund to be of individual financial significance to the group or, due to its specific nature or circumstances, include a significant risk of material misstatement to the group financial statements.
29. The integration joint boards are deemed joint ventures with the respective local authorities and accounted for under the equity method. We deemed the consolidation of the joint boards to be immaterial to the financial statements as a whole in net terms.
30. As part of our audit we reviewed the consolidation entries made within the group accounts and confirmed those entries back to the financial statements.
31. Azets is also the appointed auditor to the Endowment Fund. During our audit we liaised with the Endowment Fund audit team to confirm that their programme of work is adequate for our purposes.
32. We have nothing to report in respect of the following matters:
  - No significant deficiencies in the system of internal control or instances of fraud were identified by the Endowment Fund auditor; and
  - There were no limitations on the group audit.

## Audit differences

33. We identified eight immaterial audit differences, six of which were adjusted for within the annual report and accounts. These are outlined in

Appendix 3 and relate to (i) reclassification of profit on the sale of asset recorded against expenditure (£14.1 million), (ii) reclassification of a write off to revenue as an impairment, (iii) reclassification of accruals from deferred income (£4.2 million), (iv) reallocation of expenditure with IJB (£3.9 million – identified by both management and audit) (v) reclassification of sales invoices recorded as expenditure (£2.7 million), (vi) Scottish Government adjustment to participation in CNORIS provision following Audit Scotland's review of the work of the CLO (£1.4 million) (vii) reclassification of intangible assets recognised as tangible (£4.5 million), and (viii) reversal of overstated accrued and deferred income (£2.6 million).

34. We also identified disclosure and presentational adjustments during our audit, which were reflected in the final set of accounts. The most significant disclosure adjustment was in relation to additions to assets under construction.

## Internal controls

35. As part of our work we considered internal controls relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where we identified any control weaknesses as part of our controls testing, we have included these at Appendix 4. These matters are limited to those which we have concluded are of sufficient importance to merit being reported.

Area	Assessment	Comment
Control and process environment	<b>Satisfactory</b>	We consider the control environment within the entity to be satisfactory.
Quality of supporting schedules	<b>Satisfactory</b>	The supporting schedules received during the course of the fieldwork were of a good standard and sufficient for our audit purposes.
Responses to audit queries	<b>Satisfactory</b>	Management responses to our audit queries were appropriate and received on a timely basis.

## Service auditor reports

36. The board utilises a number of shared IT systems, IT applications and processes with other Scottish Health Boards. Assurance reports are prepared by service auditors in the health sector under ISA (UK) 402 covering the national systems/arrangements.

Shared service	Service assurance
<p><b>National Practitioner and Counter Fraud Services</b></p> <p>This contract supports accurate payments and patient registration for NHS services to GPs, dentists, pharmacists, and optometrists.</p>	<p>NHS National Services Scotland (NSS) procures a service auditor report from KPMG. In May 2022 KPMG reported an unqualified audit opinion. We considered the findings of the report and are satisfied that the findings do not have a material impact on our audit approach or conclusions.</p>
<p><b>National IT contract</b></p> <p>This contract covers the services provided by ATOS Origin Alliance e.g. controls over the server supporting eFinancials.</p>	<p>NSS procures a service auditor report from KPMG. In May 2022 KPMG reported an unqualified audit opinion. We considered the findings of the report and are satisfied that the findings do not have a material impact on our audit approach or conclusions.</p>
<p><b>National Single Instance (NSI) eFinancials</b></p> <p>NHS Ayrshire &amp; Arran host this eFinancials service, including the Real Asset Management system, on behalf of all Scottish Health Boards.</p>	<p>NHS Ayrshire and Arran procure a service auditor report from BDO. The service auditor highlighted no critical or significant risk findings and reported an unqualified opinion.</p>

## Follow up of prior year recommendations

37. We followed up on progress in implementing actions raised in the prior year as they relate to the audit of the financial statements. Full details of our findings are included in Appendix 5.

## Other communications

### Accounting policies, presentation and disclosures

38. Our work included a review of the adequacy of disclosures in the financial statements and the appropriateness of the accounting policies adopted by the board.
39. The accounting policies, which are disclosed in the annual accounts, are in line with the NHS Accounts Manual and are considered appropriate.
40. There are no significant financial statements disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately.

### Fraud and suspected fraud

41. We have previously discussed the risk of fraud with management. We have not been made aware of any incidents in the period nor have any incidents come to our attention through our audit testing.
42. 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.

### Non-compliance with laws and regulations

43. As part of our standard audit testing, we have reviewed the laws and regulations impacting the board. There are no indications from this work of any significant incidences of non-compliance or material breaches of laws and regulations that would necessitate a provision or contingent liability.

### Written representations

44. The letter of representation covers a number of issues which we asked the board to confirm to us. This letter was signed on behalf of the board as part of the process of approving the financial statements.

### Related parties

45. We are not aware of any related party transactions which have not been disclosed.

### Confirmations from third parties

46. All requested third party confirmations in respect of bank and legal confirmations were received.

# Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the Board is planning effectively to continue to deliver its services and the way in which they should be delivered.



## Auditor judgement



The Board will continue to face challenges over the next few years in achieving a balanced financial position due to a mix of COVID-19 and more general pressures on the health service. The Board's ability to develop and maintain its core services and new initiatives in a sustainable manner remains at significant risk from 2022/23 and beyond and requires continuing careful management and oversight.

## Significant audit risk

Our audit plan identified a significant risk in relation to financial sustainability under our wider scope responsibilities:

### 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 short 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.

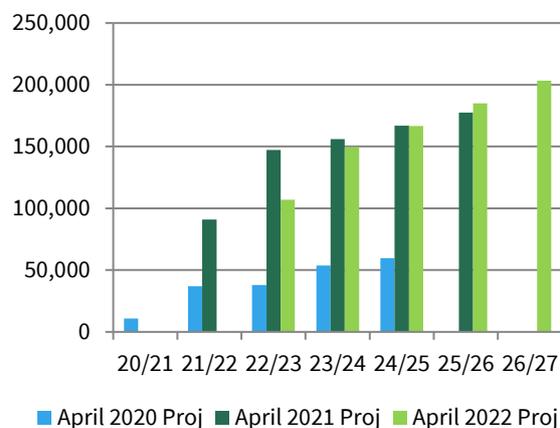
*Noted in the 2021/22 External Audit Plan*

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47. We considered how NHS Lothian balances the management of its medium and longer-term financial position with demand and performance targets, and the impact of COVID-19.
  48. We reviewed NHS Lothian's achievement of the outturn position as part of our work on financial management and the financial statements. This work highlighted that an already difficult balance between the financial resourcing and performance management landscape is becoming ever more challenging and complex, exacerbated by COVID-19 and the medium and longer term impact of the pandemic on health and related services.
  49. The board achieved the underspend in 2021/22 due to a combination of close financial management, some reliance on one-off savings, but most particularly the extra funding provided by Scottish Government to cover COVID-19 implications.
  50. Our detailed findings on the Board's financial framework for achieving long term financial sustainability are set out below.

## Financial Outlook

51. NHS Lothian's Financial Outlook & Plan projects a core financial gap of £28million in 2022/23 and £79million additional COVID-19 costs, totalling a £107million projected gap. There are pronounced increases in the deficits in the four years thereafter (to 2026/27), although the assumption from 2023/24 onwards is that the COVID-19 element of this funding gap will level out at £62million per annum.
52. The graph below shows the five year outlook, and how this has changed over the last three annual planning periods. The financial gaps projected in the April 2022 planning period broadly endorse the extremely stark financial outlook highlighted by the April 2021 exercise.
53. The COVID-19 element of the gap peaks in 2022/23 at £78.6million, before levelling to a recurring £62million. Whilst this reflects a significant element of the financial gap, the majority of the gap is explained by non-COVID costs from 2023/24 onward (and indeed rising as a proportion each year).

### Financial Gap (£'000s) – April 2020, 2021 and 2022



Source: NHS Lothian Financial Outlook & Plans

54. For 2022/23 it is recognised that the NHS remains in a fluid position, however there is a focused aim to keep on with the transition journey from the non-recurring COVID-19 NHS management plan to a recurring recovery and business as usual strategy.

### Financial plan 2022/23

55. While there are a range of factors underlying these projections, key elements include (i) a £54million baseline gap, (ii) £85million in-year (non-Covid) revised cost growth assumptions, (iii) assumed additional resources of £94million of which £45million is recurring, and (iv) offsetting efficiency/financial recovery plans in 2022/23 onwards of £17million identified to date.
56. There are various funding assumptions and recurring/non-recurring funding projections within the plan which have a net impact of notably increasing future deficit projections.

57. Delivery of savings is a fundamental component of achieving financial balance. For 2022/23, the board has a £17m savings plan, with an expected c£13million (76%) being recurring. The board itself has identified that this is “a level lower than in prior years. The challenge for 2022/23 remains however that service leads will have restricted ability to apply sufficient focus to the delivery of these recovery actions whilst delivering competing priorities, particularly relating to the ongoing challenge of Covid.”
58. With delivery of efficiency savings being categorised as “high risk” in the 2022/23 Financial Outlook and the pressures of dealing with COVID-19 alongside service backlog, this remains a key area of pressure for NHS Lothian.
59. In previous financial years, the Finance and Resources Committee has only been able to take limited assurance that the board will achieve financial balance in the year. For the 2022/23 Financial Plan and Outlook, this assurance has been reduced further, with specific citation of future funding for COVID-19, as follows: “the risks around Covid funding mean that we are not able to provide assurance on delivering a balanced financial position next year.”
60. NHS Lothian management have reported through the governance structure of the need to keep the financial plan under review and the potential for significant updates as circumstances change or new information emerges. This reflects the complex and increasingly uncertain environment.

### Key assumptions and risks in the Financial Plan

61. There are 11 “high risk” items on the Financial Outlook Risk Register (out of a total of 18 risks), including:
- SG COVID-19 allocations (assumed additional allocations, but that any overspend remains the risk of NHS Lothian - confirmation awaited at time of drafting the Financial Outlook);
  - COVID-19 activity (“high degree of uncertainty”);
  - Pay award (ie that a gap arises between agreed award and level of funding to cover);
  - Energy cost volatility;
  - Inflation volatility and level of rise across categories;
  - Access/Urgent Care: financial exposure on elective capacity pressures. The risk is that the current investment plans are revised to improve performance, without additional funding.
  - Escalation framework (reduced rating reduces funding/additional support);
  - Winter Costs (general/per previous practice and COVID-19 related);
  - Efficiency savings; and
  - Asset Sales: timing/value of assumed sales proceeds built into the extant plan.
62. Pay is identified as the single largest additional cost pressure in 2022/23, at £23.03million. The final outcome of the award is not known at time of the analysis, but assumptions were based on Scottish Public Sector Pay Policy figures. NHS Lothian is working on

the assumption that Scottish Government will cover any difference arising. Other specific cost pressures include:

- National Insurance Increase - £8.9m;
- Office 365 licensing - £2.5m;
- CNORIS - £2.5m;
- NDC/NSS Risk Share - £1m;
- Energy costs - £4.4m (baseline and new pressures).

63. From our review of the financial plans, evolving reviews and updates, and presentations made to the Finance & Resources Committee and NHS Board, it is positive to see the detailed analysis along with clear articulation of the significant risks and uncertainties. The overall projected financial gaps and outturns make for a clear and unambiguous message around the significant, strategic finance risks facing NHS Lothian.

64. Of the £79million additional COVID-19 costs projected for 2022/23, this includes:

- Vaccinations - £18m;
- Labs Testing and Sequencing - £11.5m;
- Test and Protect related costs - £3m;
- Extended hospital bed and community/discharge additional support - £13.6m
- Covid-related additional Facilities costs (including domestics, portering and logistics) - £5m; and
- GP Prescribing and Flu-related impact - £7m.

65. The inclusion of detailed, categorised 2022/23 IJB projections within the NHS Lothian five year financial outlook supports more holistic scrutiny. This includes information on areas/quantum of baseline pressures, recurring/non-recurring resource analysis, financial recovery plan values, and additional IJB COVID-19 cost pressures.

# Financial management

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



## Auditor judgement



All three key financial targets for the year were met. The Board has effective arrangements in place for financial management and the use of resources, albeit it continues to face significant resource pressures.

## Financial performance

66. All Boards have to work within the resource limits and cash requirements set by the Scottish Government.

All key financial targets were met in 2021/22. The Board delivered an underspend against its revenue resource limit of £1.422million.

### Performance against resource limits

Financial target	Limit £000	Actual £000	Variance £000
Core revenue resource limit (RRL)	2,123,228	2,121,806	1,422
Non-core revenue resource limit	56,613	56,613	-
Capital resource limit (CRL)	24,223	24,223	-
Cash requirement	2,185,727	2,185,727	-

### Financial outturn in 2021/22

67. The £1.422million under-spend against revenue resource limit (RRL) represents 0.067% of the RRL and is therefore in line with the breakeven position forecast.

68. A one-year financial plan was submitted to Scottish Government in April 2021. Due to the impact of the COVID-19 pandemic, the Scottish Government paused the three year Annual Operating and Financial Planning processes. Recognising the exceptional nature of 2021/22 and the impact on delivery plans, additional non-repayable funding was provided to support in-year financial management across all Boards.

69. The Financial Plan presented to the Board in April 2021 showed a projected deficit for the year of £25m.

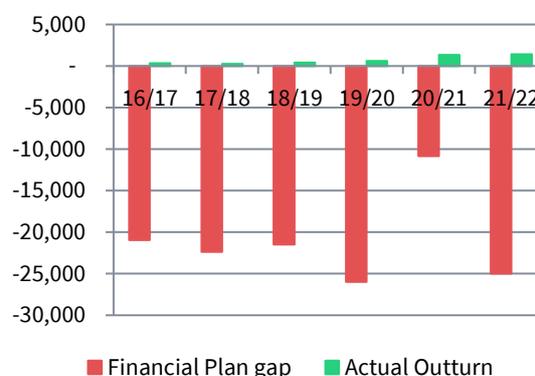
In analysing the outturn, NHS Lothian reported to its Finance & Resources Committee and to the Board that in-year benefits from an improved operational position and other one-off items of flexibility have all contributed to achieving the final year-end underspend position.

70. The position reflects a baseline operational overspend position of £6.003m offset by the net release of reserves flexibility of £7.425m, broadly categorised as follows:

Outturn - variances	£000
Pay Expenditure	10,480
Non-Pay Expenditure	(28,000)
Income	11,517
<b>Operational Position</b>	<b>(6,003)</b>
Reserves Flexibility	7,425
<b>Core Variance</b>	<b>1,422</b>

continued to meet its financial targets each year. COVID-19 funding and related financial support was significant in delivering this outcome in 2021/22. The extent to which pandemic costs are funded in 2022/23 will be a key influence on the scale of the challenge and will significantly impact the related likelihood of the board breaking even in the year.

### Analysis of outturn against financial plan gaps (£'000)



Source: Annual audit reports & financial statements

- NHS Lothian has been able to deliver financial targets in recent times in the context of increasing financial pressures from pay changes, growing demographic challenges in Lothian, strategic investment and the implementation of national policies.
- The 2021/22 year-end report to the Finance & Resources Committee identified the main areas of saving in pay budgets as being in AHPs (£2.5million), Nursing (£14.4million) and Management (£1.5million), with the first two reflecting the challenging recruitment environment versus service demand. There were also savings of £14.2 million in Administration non-pay budgets. Pay costs overspends relate to Medical (£7.2million) and Support Services (£2.7million), with non-pay overspends in areas including Drugs (£10.9million), Equipment (£16.8million) and Patient Services Agreements (£2.7million).

### Outturn in recent context

- NHS Lothian has not been able to set a breakeven budget for the past six years. Despite this, the board has

### COVID-19 financials

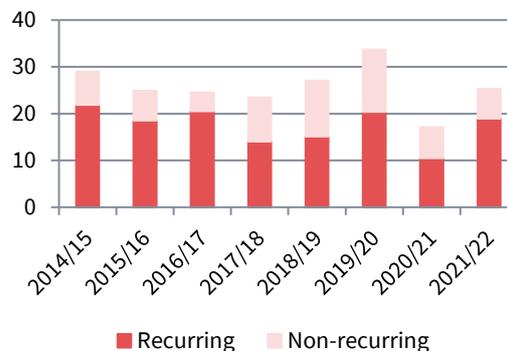
- A breakdown and analysis was prepared by NHS Lothian management and shared with the Finance and Resources Committee and Board, to support scrutiny of COVID-19 spend in 2021/22. We are pleased to note the detail and extent of analysis undertaken by the board, and the way this was reported through the governance framework to aid understanding and challenge on the financial dimensions of dealing with the pandemic.
- There has been £150million cost/lost income impact on NHS Lothian as attributed to COVID-19 for 2021/22.

76. Of this total, £40million (27%) related to the Lothian-wide vaccination programme. £26million related to Acute Services and Supplies (half of which is additional staffing, the other half is non-pay drug costs/lost income). £22m relates to Testing, Public Health, PPE costs. Other categories include Care Home (£8million), Facilities Costs (£9million), Primary Care/GPs (£6million) and Additional Community Hospital Capacity (£6million) costs.

## Efficiency Savings

77. The May 2022 Finance & Resources Committee report set out £25.315million of savings delivered in 2021/22. This was 91% of the £27.74million planned savings.
78. The level of savings achieved was a significant increase on the level achieved in 2020/21 (as impacted by the more acute phases of the pandemic). The quantum achieved reflects the extent of savings required to break even, alongside the net effect of COVID-19 funding and activity in 2021/22.
79. The proportion of savings achieved on a recurring basis in 2021/22 was at the highest level since 2016/17. The chart below outlines the historical position.

### Historic analysis of savings achieved (£m)



Source: NHS Lothian Financial Monitoring reports to Finance and Resources Committee

80. Reliance on non-recurring savings places additional pressures on the future financial position of the board and therefore requires careful management. NHS Lothian's efforts to reduce reliance on non-recurring savings is positive and the 2021/22 recurring/non-recurring split is a positive development which the board is aiming to build on in future.
81. All but three categories of savings fell short against planned levels. The Acute Services Division was over £0.651million short (achieving just 95.3% of target, with most of the savings on a recurring basis), Edinburgh Partnership savings were £1.463million below target (achieving under two-thirds of the annual target), and Strategic Services recorded no savings against the £0.384million target.

## Systems of internal control

82. We have evaluated the Board's key financial systems and internal financial controls to ensure internal controls are operating effectively to safeguard public assets.

83. We did not identify any significant weaknesses in the Board's accounting and internal control systems during our audit, although we have raised a limited number of opportunities to improve arrangements (see Action Plan in Appendix 4).

## Internal audit

84. An effective internal audit service is an important element of NHS Lothian's governance arrangements and supports the system of internal control. The NHS Lothian internal audit service is provided through a co-sourced arrangement with Grant Thornton. The service operates in line with Public Sector Internal Audit Standards. During our audit we considered the work of internal audit wherever possible to avoid duplication of effort and make the most efficient use of NHS Lothian's audit resource.

## Prevention and detection of fraud and irregularity

85. Our audit was planned to provide a reasonable expectation of detecting material misstatement in the financial statements resulting from fraud and irregularity. We found the Board's arrangements for the prevention and detection of fraud and other irregularities to be adequate and appropriate.
86. The Fraud Liaison Officer provides an annual report to the Audit and Risk Committee outlining any cases that have been referred to Counter Fraud Services, and the progress of any investigations. The Audit and Risk Committee also receives updates on current counter fraud activity from the Fraud Liaison Officer at each meeting.

## National fraud initiative

87. The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies to identify fraud and error.
88. The last completed NFI exercise commenced in 2020. We completed a questionnaire and submitted this to Audit Scotland earlier this year to inform planning for the 2022/23 NFI. Overall we concluded that NFI arrangements are satisfactory, and that the Board has taken a reasonable and proportionate approach to investigating matches.

# Governance and transparency



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



## Auditor judgement



Governance arrangements continue to be satisfactory and appropriate. The Board made minimal changes to its governance arrangements as a result of COVID-19, meeting frequently during 2021/22 to provide effective scrutiny, challenge and oversight and receive assurance on the management of risk.

## Governance and transparency

### Audit risks

89. Our audit plan identified no significant risks in relation to governance and transparency under our wider scope responsibilities. However, we paid particular attention to COVID-19 and remobilisation planning.

### Board appointments

90. The following changes in board composition occurred during 2021/22 or in 2022/23 thus far:

- Susan Goldsmith retired as Director of Finance and was replaced by Craig Marriott (previously Deputy Director of Finance) in May 2022;
- Several non-executives have changed; Michael Ash and Alison Mitchell left the Board in April 2021, and Elizabeth Gordon, Nadin Akta, Peter Knight, Philip Allenby, Val de Souza and Andrew Fleming all took office in April 2022 to fill extant and pending vacancies;
- Tom Waterson sadly passed away during 2021/22 and was replaced by Tracey Anne Miller as Employee Director;
- After Interim Directors of Nursing, Midwifery and AHPs in 2021/22 and early 2022/23, Alison MacDonald was appointed to this post permanently from 20 June 2022;
- Dona Milne replaced Katie Dee as Director of Public Health at the end of May 2021; and

- There were both reappointments and new appointments made to local authority Board representatives due to the May 2022 local elections.

### COVID-19 governance

91. Whilst it is acknowledged that no single approach would fit all boards in dealing with the pandemic, the Scottish Government advised each board to ensure the model they adopt “enables agile and effective decision making, places staff and their resilience at the centre and builds important links with the public and the community at this time. Boards should also continue to operate in an open and transparent manner”.
92. The Board made minimal changes to its governance arrangements as a result of COVID-19, seeking to maintain efficient and effective governance throughout the pandemic.
93. After a temporary cessation of public board meetings between April and December 2020, the board put in place a facility to allow the public to observe board meetings online and this has continued over 2021/22 in order to support transparency and public reporting.
94. The Staff Governance Committee has continued to have a high degree of focus on COVID issues such as the workload of clinical staff, any whistleblowing issues and to ensure oversight of health and safety.
95. The Staff Governance Committee met regularly during the year and covered all of the above issues. The

committee agreed to accept a significant level of assurance that NHS Lothian had developed, approved and implemented year 1 of a staff strategy and had infrastructure in place to support delivery.

96. Likewise, the Finance and Resources Committee, Healthcare Governance Committee, Audit and Risk Committee and the Board itself met frequently during 2021/22 to provide scrutiny and oversight and receive assurance on the management of risk, including progress on the vaccination programme.

## Remobilisation

97. The COVID-19 response and related wider service mobilisation was coordinated through the NHS Lothian Gold Command structure and management group, made up of NHS Lothian senior leaders and health and social care Directors. This group met frequently across the year and increasingly looked at further and wider roll out of non-pandemic services as the year went on. Remobilisation plans have been subject to scrutiny and approval by the NHS Lothian Board, as part of ongoing oversight and pandemic response.

98. NHS Lothian's mobilisation broadly reinforces extant strategic plans and strategies, with a specific goal to minimise the number of individuals physically attending a facility and further driving more adoption and use of technology to deliver remote and e-health solutions. The mobilisation plan set out the following service priorities:

- Diagnostics and treatment for cancer.

- Urgent treatment for cardiac disease, transplants, renal failure.
- Support and treatment for mental health difficulties.
- Routine treatments where additional delays caused by the pandemic may have made the clinical picture an urgent one.
- Services for children, where the impact on a child's development could be disproportionate.
- Dental and ophthalmic services where significant underlying disease may have built up.
- General Medical Practice capacity to see patients with non-urgent but significant health problems that will worsen over time.

## 2021/22 developments

99. Several new and revised initiatives were undertaken in 2021/22 to support continuous improvement in NHS Lothian's governance arrangements. These include:

- The local induction programme for new Board members was refreshed, with acknowledgement of the changes in membership as noted above. This has drawn from the nationally developed template and guidance for local induction for Board members.
- An active governance session was held with the Board as part of the development programme, aligned to national work on good governance. This has since led to a revised approach and format of certain reporting to the Board and the Planning, Performance & Development Committee, in line

- with the principles of active governance.
- The corporate risk register approach has been scrutinised by the Board, leading to amendments to the formatting of reporting to the Board and Committees and increased focus on risk mitigation and the way forward to tackle/manage recorded risks.
  - The NHS Lothian Board has restated its commitment to developing systems of governance in line with good practice from the Scottish Government (such as the Blueprint for Good Governance).

## Fairness and Equalities

100. NHS Lothian follows the NHS Scotland Staff Governance Standard, the aims of which are to improve how NHS Scotland's diverse workforce is treated. The Lothian Strategic Development Framework (LSDF) describes what NHS Lothian is trying to achieve, the current situation, the challenges faced and the direction of travel proposed to support continuous improvement. NHS Lothian has a corporate objective which is subject to quarterly review by the Corporate management team and annual review by the Healthcare Governance Committee to this effect.
101. Up to date equality and diversity information is held on staff but NHS Lothian aims to continue with efforts to make this data as robust as possible. Previous monitoring reports highlighted issues for further analysis and effort in the nurses and midwives cohort, and from this the "Leading Better Care, Leading Across Differences" project was initiated. This is a continuous process which is progressing again to another leadership programme to be led by the Director of Nursing.
102. All staff are required to complete a mandatory module on Equality and Diversity at least every three years, with the content and material regularly and recently updated. There are five staff equality networks recognised and supported by senior management which engage in learning activities across the organisation. These take place regularly and are supported at a senior level.
103. In terms of public reporting, NHS Lothian has a four-year mainstreaming report for the EHRC, followed by a two-year update report. Both reports reflect activity in relation to mainstreaming, staff equality profile data, and update on equality outcomes, and they are published on the NHS Lothian website and shared with key networks.
104. Development of an Advancing Equalities Action Plan 2022-2023 has been led by the NHS Lothian Staff Networks, with support from the Corporate Management Team to address and promote equality across the organisation and beyond. This is also happening alongside development plans for Board members to undertake further equality and diversity training as part of the forward training programme.
105. To aid service planning, NHS Lothian encourages staff to improve demographic data recording to improve service delivery and health outcomes, and directs use of Integrated Impact Assessments (IIA) to help ensure that new service

developments do not disadvantage key groups. The organisation also has the following services to help respond to the needs of different groups:

- Minority Ethnic Health Inclusion Services (MEHIS)
- Interpretation Services inc BSL and Big Word
- Easy Read versions of some plans
- Leaflets and other information available in multiple languages
- Community messaging committee to help with communication and different communities
- 'Make intention visible' – including use of social media during Pride, Black History Month etc.

106. NHS Lothian's Integrated Impact Assessment is designed to proactively consider socioeconomic inequalities as part of the process. Such an assessment was conducted on the draft Lothian Strategic Development Framework. As the Framework continues to pursue action plan activities, each element is planned to be assessed as required.

### Overall conclusion

107. Through our review of board and committee papers, governance statement disclosures and other evidence gathered during our audit, we are satisfied that there has been effective scrutiny, challenge and informed decision making throughout 2021/22.

# Value for money

Value for money is concerned with using resources effectively and continually improving services. In this section we report on our audit work as it relates to the Board's reporting of its performance.



## Auditor judgement



Whilst an established and appropriate performance management framework is in place at NHS Lothian, the pandemic has exacerbated what were already tough core service delivery challenges. Making progress to tackle the wide range of performance metrics in the medium term has never been more demanding.

## Significant audit risks

108. Our audit plan identified significant risks to value for money under our wider scope responsibilities. These related to (i) Royal Hospital for Children and Young People project, and (ii) general performance issues.

### 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 reports. 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.

*Noted in the 2021/22 External Audit Plan*

109. The hospital fully opened to service users on 23 March 2021. This followed completion of service migration plans, satisfactory progress against project management milestones/actions, appropriate resolution of outstanding rectification works, and further testing and inspection of the facility. The Board, its Committees and the Executive Team have all been involved in regular reporting and scrutiny of developments over the year.
110. A post-occupancy review remains outstanding (anticipated post-inquiry), and the public inquiry led by Lord Brodie is well underway. In late June 2021 it held a Procedural Hearing, reflecting work to date, the planned way forward, and set out the hearings to take place from September 2021 onwards. The Inquiry website and related public-facing media for the Inquiry has been providing regular news and updates, along with a range of contextual and background documentation.
111. Hearings have taken place between September 2021 and early November 2021 (primarily focussing on the Queen Elizabeth University Hospital in Glasgow) and in May 2022 (with a more specific focus on NHS Lothian and the Royal Hospital for Children and Young People facility). The May 2022 hearings focussed primarily on two themes; the role of ventilation in a hospital setting, and the early planning stages of the project. The Inquiry stated that this set of hearings was to deal with the roles of NHS Lothian, the Scottish Futures Trust and the Scottish Government in relation

to the early development of the RHCYP project, hearing evidence from said representatives and a range of wider professional experts on relevant technical matters.

112. NHS Lothian has shared a range of papers and working documents further to these hearings, in support of the Inquiry's work. The NHS Lothian Board has had regular update and agenda discussion points to keep engaged, informed and aligned with the Inquiry. Whilst we cannot comment on the specifics of the Inquiry nor do we wish to pre-empt or cut across its work, we are pleased to note that in July 2022 its official update noted "solid progress with its investigations into both hospitals" and "evidence heard from witnesses...in May 2022 is informing work preparing for the next hearing which will consider the procurement process of the hospital". Further "Whilst good progress has been and continues to be made in respect of both hospitals, there is still a great deal of information to be collected and analysed in light of engagement with potential witnesses and core participants."
  113. To support scrutiny of significant submissions and related work and with an intention to give sufficient time and cognisance of future witness hearings, in July 2022 Lord Brodie announced as "short as possible (postponement of pending hearings) and an announcement on the dates of the hearings will be made in due course". External audit will continue to monitor developments going forward.
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## Performance

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.

*Noted in the 2021/22 External Audit Plan*

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114. Performance metrics (where available and comparable) show a range of areas of both continuing challenge and deterioration in performance standards compared to prior year, primarily due to the strains of balancing COVID-19 activity with remobilisation and tackling the backlog. Even after more than two years, the pandemic will continue to impact metrics across a range of areas for some time to come.
115. The unique circumstances arising from COVID-19 make it difficult to make comparisons across years, and we acknowledge that the NHS Lothian remobilisation plan has been an area of focus and organisational effort, balancing COVID-19 and wider system pressures.
116. We note that the Chief Executive's statement within the 2021/22 Annual Accounts addresses these matters directly, noting and contextualising NHS Lothian's performance outcomes and asserting that "Looking ahead, if NHS Lothian is ever to achieve and sustain the level of performance which the Scottish Government and the public expects, there will need to be significant transformational change. A key issue is funding" and that "NHS Lothian simply does not have the operational capacity to meet the demand for and performance standards for its services." Such direct and pointed assessment underscores NHS Lothian's operating context and how this bodes for future outcome measures.

### Paediatric Audiology

117. The Scottish Public Services Ombudsman (SPSO) highlighted concerns within NHS Lothian's Paediatric Audiology service which resulted in an externally commissioned expert review. This found significant diagnostic and testing process issues, for which the

board has publicly apologised. An action plan was drawn up from the review and is being implemented. The Planning, Performance and Development Committee has reviewed the detail of the service failure identified within the Audiology service and the planned recovery programme. It has also been overseeing progress against agreed actions; all nine “urgent” recommendations have been reported as complete, along with all but 5 of the 19 “high” graded, the remainder being “partially complete”. Five of the remaining actions remain in progress.

### Breast Cancer Screening

118. NHS Lothian acknowledged failures in the call/recall system for the Increased Risk Breast Cancer Screening Programme. This meant some individuals were not invited for screening at expected intervals. The incident was reported on 12 October 2021 and an Adverse Event Management Team (AEMT) was established on 14 October 2021. A serious adverse event (SAE) review was undertaken in accordance with standard NHS Lothian protocols.
119. Regular updates on response actions have been provided to NHS Lothian’s Patient Safety Executive Advisory Group since, with updates through the governance framework to the Board (via the Healthcare Governance Committee). A systematic process has been put in place to contact, offer screening and/or liaise with appropriate partners (eg if the individual concerned no longer resides in Scotland), along with refresher training and increased and targeted audit/verification checks. This remains an ongoing area of work, as NHS Lothian’s report to the Healthcare Governance Committee notes that “until the investigation is completed...the full scale (of any harm that has resulted from this adverse event) is unknown.”

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## Performance Summary

120. The key areas of focus for NHS Lothian during 2021/22 have been continuing to manage and respond to COVID-19 related pressures, wider service remobilisation and recovery, and supporting Scottish Government priorities in relation to mental health and waiting times.

121. The Remobilisation Plan for 2021/2022 aligned to the “Re-mobilise, Recover, Re-design: The Framework

for NHS Scotland” published by the Scottish Government. As the board developed and implemented these plans, it continued to embed new ways of working, whilst looking to support the physical and psychological wellbeing of the workforce after a sustained period of impact from dealing with the pandemic.

122. Throughout the pandemic, NHS Lothian has focussed on maintaining a balance between the response to the pandemic and the continued safe

provision of non-Covid services. The overriding priority in setting that balance continues to be the safe delivery of services, taking into account the impact and implications of the different “waves” of the pandemic and related variants. The board has worked to prioritise “life and limb” cases and urgent diagnostics and treatments.

123. In terms of risks during this remobilisation phase, there are several related corporate risks with corresponding action plans for the areas of performance, with assurance and reporting structures in place for these across the Board’s existing Committee and governance structures.
124. The Board monitors its performance against a range of high level key

performance metrics which are set out in the NHS Lothian performance framework and the recovery and remobilisation plans. A range of quality and safety metrics are also considered by the Healthcare Governance Committee.

125. NHS Lothian Board members and senior management have clear and regular reporting to scrutinise and oversee operational and strategic performance. The framework is in place and continues to evolve, but the challenges over 2021/22 - primarily the environmental operating context and continued pandemic impact - have continued to adversely impact the outcomes in almost all LDP standard areas compared to prior periods. This can be seen in the following waiting times data:

Target/standard	Performance at March 2022		Mar-21	Mar-20	Mar-19
At least 95% of patients referred with suspicion of cancer treated within 62 days	79.3%	Standard not met and deteriorating performance	82.8%	83.5%	94.9%
<b>Analysis:</b> The accumulated effect of sustained high referral numbers, staffing challenges experienced over winter and a reduced capacity over Christmas and New Year impacted 62-day performance.					
At least 95% of patients diagnosed with cancer to be treated within 31 days	96.8%	Standard met	97.9%	95.2%	79.4%
<b>Analysis:</b> Whilst performance was impacted by sustained referral numbers, ongoing staff challenges and a reduction in bed and theatre capacity (and wait time for outpatient appointments, endoscopy and radiology exceeded two weeks at times), the board still achieved this standard.					
At least 90% of patients to be treated within 18 weeks of Referral	74.5%	Standard not met and deteriorating performance	77.3%	76.4%	70.9%
<b>Analysis:</b> Backlog into 2021/22, and as NHS Lothian services began to remobilise capacity was constrained by the requirement for additional infection control measures. In addition, further waves of the virus in 2021/22 slowed the recovery of services due to the need to again pause or reduce services for reasons including staffing availability or the need to divert resources because of an increase in unscheduled hospitalisations.					

100% of Inpatient and Day cases covered under the Treatment Time Guarantee to be seen in 12 weeks	65.3%	Standard not met and deteriorating performance	67.3%	75.2%	73.6%
<p><b>Analysis:</b> The impact of limited theatre, bed and staffing capacity for a sustained period throughout the pandemic has been evident in the growing TTG waiting list, and the number of longer waiting non-urgent patients. There was also a trend of increasing urgent and cancer demand, adding to the ongoing pressure of limited capacity available to meet the backlog of non-urgent patients.</p>					
Outpatients waiting less than 12 weeks	51.4%	Standard not met and deteriorating performance	% data not available to compare	64.1%	64.5%
<p><b>Analysis:</b> Outpatient activity returned to and at some points exceeded pre-COVID levels, through increased virtual and face-to-face appointments, some external provision where available, and some Waiting List Initiatives. This capacity was prioritised on a clinical basis and for the longest waiting patients.</p>					
At least 95%, with an ambition of 98%, of unscheduled care patients to be admitted, treated or discharged within 4 hours	65.7%	Standard not met and deteriorating performance	84.8%	86.3%	87.7%
<p><b>Analysis:</b> This was a result of a combination of factors including maintaining red and amber pathways in the emergency departments. Although first assessments accounted for the majority of breaches, bed waits and treatment end waits were responsible for a larger number than in previous years. Due to pressures observed across the system, the ability to admit patients from Emergency Departments reduced, with hospital occupancy remaining high.</p>					
At least 90% of Psychological Therapy patients to be treated within 18 Weeks	74.5%	Standard not met and deteriorating performance	79.2%	78.0%	77.2%
<p><b>Analysis:</b> A challenging environment for this service and so performance has been impacted by ongoing external circumstances and events.</p>					
At least 90% of Child and Adolescent Mental Health Patients to be treated within 18 weeks of referral	63.1%	Standard not met and improving performance	57.1%	53.9%	58.6%
<p><b>Analysis:</b> The improvement in performance in 2021/22 is related to several factors. This includes the ability of the services to increase staffing establishment, a continued focus on Choice and Partnership Approach (CAPA) implementation across all NHS Lothian teams, and the utilisation of the HEALIOS (mental health partner) team.</p>					

### Delayed discharges

126. In early 2020/21 the number of delayed discharges in NHS Lothian were at an all-time low due to measures put in place to manage COVID-19 pressures, including an increase in the number of community

beds and a focus on Home First. However, they returned to historical benchmark levels after May 2021. March 2022 data shows 280 delayed discharges within NHS Lothian hospitals, compared to 165 delayed discharges 12 months earlier. The

greater the level of delayed discharge cases, the more significant the impact on patient flow and performance.

127. Health and Social Care/IJB delays grew significantly in the latter part of the year, primarily due to challenges with Package of Care capacity in the care sector. Edinburgh IJB in particular saw a stark rise in cases, from 122 in March 2021 to 242 in March 2022.
128. Overall, the systemic underlying reasons for delays include patient delays related to care required to live in their own home or nursing/residential home and community workforce capacity issues.

## Performance Outlook

129. Transformational service redesign and the effective use of resources will be essential to medium and longer term performance improvement and sustainability, but the operational and financial context of the board exacerbates the difficulty in working towards and achieving this strategic outcome.
130. It is difficult to see how NHS Lothian will return to performing at or around the LDP standard levels without significant reorganisation, resource analysis and alignment, and the related time to tackle both the pre-Covid and pandemic-related backlog challenges.

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# Appendix 1: Respective responsibilities of the Board and the Auditor

## Board responsibilities

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.

Area	Board responsibilities
<b>Corporate governance</b>	<p>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.</p>
<b>Financial statements.</b>	<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 their 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; and</li> <li>• preparing and publishing, along with the financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that is consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also address the longer term financial sustainability of the Board.</li> </ul> <p>Management is responsible, with the oversight of those charged with governance, for communicating relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.</p>

Area	Board responsibilities
	<p>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 its objectives and safeguard and secure value for money from the public funds at its disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.</p>
<b>Standards of conduct for prevention and detection of fraud and error</b>	<p>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.</p>
<b>Financial position</b>	<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 statutory financial requirements and achievement of financial targets;</li><li>• Balances and reserves, including strategies about levels and their future use;</li><li>• Plans to deal with uncertainty in the medium and long term; and</li><li>• The impact of planned future policies and foreseeable developments on the financial position.</li></ul>
<b>Best value</b>	<p>Accountable officers have a specific responsibility to ensure that arrangements have been made to secure best value.</p>

## Auditor responsibilities

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; and
- demonstrate compliance with the wider scope of public audit.

### Wider scope of audit

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 providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

The Code of Audit Practice frames a significant part of our wider scope responsibilities in terms of four audit dimensions: financial sustainability; financial management; governance and transparency; and value for money.

## Independence

In accordance with our profession's ethical guidance and further to our External Audit Annual Plan issued confirming audit arrangements there are no further matters to bring to your attention in relation to our integrity, objectivity and independence.

We confirm that Azets Audit Services and the engagement team complied with the FRC's Ethical Standard. We confirm that all threats to our independence have been properly addressed through appropriate safeguards and that we are independent and able to express an objective opinion on the financial statements.

### Audit and non-audit services

In addition to our audit work on the board's financial statements we are also responsible for the review of the abstract of receipts and payments of patients' private funds. The non-audit fee for this work in 2021/22 is expected to be around £3,025. FRC's Ethical Standard stipulates that where an auditor undertakes non audit work, appropriate safeguards must be applied to reduce or eliminate any threats to independence.

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 total fees charged to the board for the provision of services in 2021/22 are as follows:

	Current year £	Prior year £
Audit of NHS Lothian (Auditor remuneration)	248,115	245,685
<b>Total audit</b>	<b>248,115</b>	<b>245,685</b>
Non-audit services (Patients' Private Funds audit)	3,025	2,750
<b>Total fees</b>	<b>251,140</b>	<b>248,435</b>

## Audit quality

The Auditor General and the Accounts Commission require assurance on the quality of public audit in Scotland through comprehensive audit quality arrangements that apply to all audit work and providers. The audit quality arrangements recognise the importance of audit quality to the Auditor General and the Accounts Commission and provide regular reporting on audit quality and performance.

Audit Scotland maintains and delivers an [Audit Quality Framework](#).

The most recent audit quality report which covers our work at the Board since appointment can be found at <https://www.audit-scotland.gov.uk/publications/quality-of-public-audit-in-scotland-annual-report-202122>

## Appendix 2: Performance against resource limits

All Boards have to work within the resource limits and cash requirements set by the Scottish Government.

All key financial targets were met in 2021/22. The Board reported a saving against its revenue resource limit (RRL) of £1,422,000.

Financial target	Limit £'000	Actual £'000	Variance £'000	Target achieved?
Core revenue resource limit	2,123,228	2,121,806	1,422	Yes
Non-core revenue resource limit	56,613	56,613	-	Yes
Capital resource limit	24,223	24,223	-	Yes
Cash requirement	2,185,727	2,185,727	-	Yes

## Appendix 3: Adjusted and unadjusted differences identified during the audit

### Adjusted differences

We did not identify any material adjustments during our audit of NHS Lothian's annual report and accounts. Our summary of adjusted audit differences is presented below.

No	Detail	Assets	Liabilities	Reserves	SoCNE
Details of adjusted audit differences		Dr / (Cr)	Dr / (Cr)	Dr / (Cr)	Dr / (Cr)
		£m	£m	£m	£m
1.	Reclassification of profit on sale of asset recorded against expenditure				Expenditure: 14.1 Operating income: (14.1)
2.	Reclassification of a write off to revenue as an impairment				Impairment: 13.0 Expenditure: (13.0)
3.	Reclassification from deferred income to accruals		Deferred income: 4.2 Accruals: (4.2)		
4.	Reallocation of IJB expenditure				Expenditure: 3.9 Staff costs: (3.9)
5.	Reclassification of sales invoices recorded against expenditure				Expenditure: 2.7 Operating income: (2.7)
6.	Scottish Government adjustment to participation in CNORIS provision		Provisions: 1.4		Expenditure: (1.4)
Total impact on SoCNE					(1.4)

## Unadjusted differences

Our summary of unadjusted audit differences is presented below. We have discussed these with management and confirmed that all unadjusted differences are collectively and individually immaterial.

No	Detail	Assets	Liabilities	Reserves	SoCNE
Details of unadjusted audit differences		Dr / (Cr)	Dr / (Cr)	Dr / (Cr)	Dr / (Cr)
		£m	£m	£m	£m
1.	Reclassification of intangible assets recognised as property, plant and equipment	Intangibles: 4.6  PPE: (4.6)			
2.	Reversal of overstated accrued and deferred income	(2.6)	2.6		
Total impact on SoCNE					(-)

## Disclosure amendments

No	Detail
1.	Governance Statement – further disclosures made on issues raised within certificates of assurance
2.	Remuneration Report – updated to correctly reflect underlying source information
3.	Property, Plant & Equipment – updated to separately identify write offs to revenue rather than disclosing these as negative additions
4.	Commitments under leases – updated to correctly reflect underlying records

## Appendix 4: Action Plan

Our action plan details the weaknesses and opportunities for improvement that we have identified during our audit.

The recommendations are categorised into three risk ratings:

**Key:**

**Significant deficiency**

**Other deficiency**

**Other observation**

<b>1. Suspense and control account reconciliations</b>		<b>Other observation</b>
<b>Observation</b>	<p>NHS Lothian had two suspense accounts with balances over our trivial threshold of £250k as at 31 March 2022. Whilst suspense and control accounts were reviewed by management at year end, investigation of transactions and timely review was not clearly evidenced.</p> <p>The two suspense accounts identified contained debit and credit balances relating to the same transaction that offset one another and we therefore do not deem this to be material to the accounts.</p>	
<b>Implication</b>	<p>Unusual or fraudulent journals which may have been concealed within suspense accounts may not be identified in a timely manner.</p>	
<b>Recommendation</b>	<p>Management should ensure that the review of suspense and control accounts is appropriately documented, recording the explanation and/or action taken for each transaction.</p>	
<b>Management response</b>	<p>All control / suspense accounts reconciliations have assigned owners, reviewers. Evidence of the reconciliations carried out is collected by the Financial Accounts team at which point it is recorded who performed specific reconciliation and who reviewed it. These specific accounts in question are routinely used as part of the monthly business processes, however explanation for these items was not recorded as staff carrying out reconciliation / reviewing are familiar with these processes. Therefore the risk of these items concealed / not identified in a timely manner is trivial. We accept, however, that there could have been a clearer way to evidence the performance and review of reconciliations.</p> <p><b>Responsible Officer:</b> Director of Finance</p> <p><b>Implementation Date:</b> Immediately</p>	

## 2. Sales invoices in expenditure

Other deficiency

<b>Observation</b>	We noted a small number of sales invoices totalling £2.6 million that had been incorrectly classified as expenditure. We do not deem this to be material to the annual accounts.
<b>Implication</b>	Understatement of both income and expenditure
<b>Recommendation</b>	Management should ensure sufficient procedures, training and checks are in place to support the correct classification of sales and purchase invoices.
<b>Management response</b>	<p>Recommendation accepted.</p> <p>As part of the normal operations Accounts Receivable team reviews and amends the coding of sales invoices, where required. However not all invoices are raised through the team, therefore 100% check is not possible.</p> <p>We will review the misclassification in more detail and will provide targeted training, as appropriate.</p> <p><b>Responsible Officer:</b> Director of Finance</p> <p><b>Implementation Date:</b> 31 December 2022</p>

### 3. Accounting for lifecycle maintenance

Other deficiency

<p><b>Observation</b></p>	<p>The board incurs annual costs relating to lifecycle maintenance on Royal Infirmary Edinburgh. This is incorrectly accounted for as a payment of a capital grant and the board receives non-core RRL funding to cover this. As the asset is now held on the board's balance sheet, this spend should be classified as core expenditure and be covered by core RRL funding.</p> <p>We do not deem this to be material to the accounts and are satisfied that this misclassification does not impact the board's performance against the overall RRL target.</p>
<p><b>Implication</b></p>	<p>Current accounting treatment is not in line with the FReM or the NHS Capital Accounting Manual and funding is therefore being incorrectly allocated.</p>
<p><b>Recommendation</b></p>	<p>Management should ensure lifecycle maintenance costs on Royal Infirmary Edinburgh are accounted for as core expenditure and covered by core RRL funding.</p>
<p><b>Management response</b></p>	<p>Recommendation agreed. The Property and Asset Management Finance team undertake a capital grants forecast at mid year review. From 2022/23 this will exclude lifecycle maintenance spend at the Royal Infirmary of Edinburgh, which will instead be treated in line with the process for investments in properties directly owned by the Board.</p> <p><b>Responsible Officer:</b> Director of Finance  <b>Implementation Date:</b> 31 December 2022</p>

#### 4. Assets under construction

#### Other deficiency

<b>Observation</b>	<p>In 2021/22 we noted balances of £22.5 million within assets under construction that have been written off to revenue. In addition, we noted balances of £11 million within assets under construction that have been reclassified as the payment of capital grants as the spend relates to assets not held by the board.</p> <p>These significant adjustments reflect the work undertaken by management to review historic balances held within assets under construction. To avoid this scale of movement in future years, and to ensure that the reasons for all write-offs are understood and addressed timeously, this exercise should be undertaken on a more regular basis.</p>
<b>Implication</b>	<p>Potential overstatement of asset under construction if revenue transactions, including payment of capital grants, are not identified in a timely manner.</p> <p>Potential failure to learn lessons and address issues raised by write offs.</p>
<b>Recommendation</b>	<p>Management should undertake sufficiently regular reviews during the lifetime of each project to ensure that capitalised spend is not materially misstated at the year end and the reasons for write-offs are fully understood and addressed as appropriate.</p>
<b>Management response</b>	<p>Recommendation accepted. Following discussion with external audit, the Property and Asset Management Finance team has established an ongoing programme of AUC review to ensure any balances written off or completed are assessed for appropriate treatment, with this reflected in the ledger in a timely manner. This is undertaken and reported internally on a monthly basis.</p> <p>Where major projects span across multiple financial years, the team will review the risk of material misstatement arising from the AUC balances and seek internal or external assessment of the value to be written off to revenue part way through the project if required.</p> <p><b>Responsible Officer:</b> Director of Finance</p> <p><b>Implementation Date:</b> 31 March 2023</p>

## 5. PFI contract expiry

Other deficiency

<p><b>Observation</b></p>	<p>A number of NHS Lothian’s PFI contracts are now approaching the end of their term.</p> <p>In view of the complexity of many PFI contracts and the length of time since they were initiated, the board will need to give early consideration of the nature and level of resource required to manage the contract expiry process. The Scottish Futures Trust and the UK government’s Infrastructure and Projects Authority have issued guidance which suggests that, for complex facilities such as acute hospitals, preparation for handback needs to commence between eight and ten years before the end of the contract. The guidance also notes that the expiry process will require more and different senior management support than is currently being provided to the PFI project.</p> <p>The board’s risk register contains references to PFI asset handover but does not include a specific risk and mitigating actions regarding PFI contract expiry.</p>
<p><b>Implication</b></p>	<p>There are specific risks in the expiry phase of PFI contracts, for example around the quality of assets on hand-back and the availability of data and information to manage assets and services post PFI expiry. In addition, there can be relationship pressures as PFI investors look to optimise returns prior to expiry. These risks will need to be carefully managed to avoid disruption to facilities and services.</p>
<p><b>Recommendation</b></p>	<p>We recommend the board considers including the risks relating to PFI contract expiry on the corporate risk register.</p>
<p><b>Management response</b></p>	<p>Management accepts the recommendation. Appropriate risks will be added to the Corporate Risk Register.</p> <p><b>Responsible Officer:</b> Director of Finance</p> <p><b>Implementation Date:</b> 31 October 2022</p>

## Appendix 5: Follow up of prior year recommendations

We have followed up on progress in implementing the outstanding actions raised in prior years.

### Research and development (R&D) income

**Recommendation** The Board is not recognising R&D income from commercial contracts in line with IFRS 15 *Revenue from Contracts with Customers*, but is instead recognising income in relation to expenditure incurred. Management should revise the current approach to recognising R&D income in line with IFRS 15.

**Rating**

**Other deficiency**

**Implementation date:**

31 March 2022

**Closed**

The Board has undertaken significant work on the recognition of commercial research and development revenue. New systems and processes have been implemented to estimate the level of completion of studies. The Board believes that the changes allow for more timely invoicing and better management information.

### Year-end asset procedures

**Recommendation** We encourage NHS Lothian to complete a review of assets under construction and the useful life of revalued assets to ensure appropriate accounting treatment in 2020/21. Going forward, a review of completed assets should be undertaken as part of the accounts preparation process to ensure the correct treatment is applied.

**Rating**

**Other deficiency**

**Implementation date:**

31 March 2022 (original: 31 March 2021)

**Closed**

NHS Lothian has undertaken a review of asset under construction balances at year end.

### Disputed capital accrual

**Recommendation** We identified a capital accrual for £508k that relates to a disputed transaction with a public sector partner that occurred in 2014. No recent action has been taken to resolve this dispute. Management should ensure appropriate action is taken to resolve the disputed transaction and ensure it is appropriately accounted for.

Rating	Other deficiency	Implementation date:
		31 March 2022

<b>Closed</b>	NHS Lothian has resolved the disputed transaction with the public sector partner.
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### Asset Verification

**Recommendation** Minimal asset verification has been undertaken by management since 2018/19. A plan had been established to undertake the exercise annually on a risk assessed sample basis; however, due to COVID -19 restricting access and resourcing constraints, this has not been followed in 2019/20 or 2020/21. Management should ensure appropriate and sufficient asset verification is undertaken on an annual basis.

Rating	Other deficiency	Implementation date:
		31 March 2022

<b>Closed</b>	In 2021/22 NHS Lothian restarted formal asset verification on a rolling basis to verify all assets on the asset register on a 5-year cycle. The exercise focused on higher risk assets including lower value items of plant and machinery. The exercise resulted in 1,259 assets being removed from the asset register, of these 1,222 had nil net book value. The asset lives of equipment categories were reviewed after verification and useful lives of 119 assets were reassessed.
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