NHS Orkney

Annual Audit Report to the Board and the Auditor General for Scotland

05 July 2024

Key contacts

Your key contacts in connection with this report are:

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Introduction

To the Audit Committee of NHS Orkney

We are pleased to have the opportunity to meet with you on 27 June 2024 to discuss the results of our audit of the consolidated financial statements of NHS Orkney (the 'Board'), as at and for the year ended 31 March 2024.

We are providing this report in advance of our meeting to enable you to consider our findings and hence enhance the quality of our discussions. This report should be read in conjunction with our audit plan and strategy report, presented on 5 March 2024. We will be pleased to elaborate on the matters covered in this report when we meet.

Our audit is in progress. Please refer to page 6 for the details in relation to the change in our audit plan.

We are intending to issue an unmodified Auditor's Report on the consolidated financial statements.

We draw your attention to the important notice on page 4 of this report, which explains:

- The purpose of this report;
- Limitations on work performed; and
- Restrictions on distribution of this report.

Yours sincerely,

R. K. Khangura

Rashpal Khangura

05 July 2024

How we have delivered audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

We define 'audit quality' as being the outcome when audits are:

– **Executed consistently**, in line with the requirements and intent of **applicable professional standards** within a strong **system of quality controls** and

– All of our related activities are undertaken in an environment of the utmost level of **objectivity**, **independence**, **ethics** and **integrity**.

Audit Scotland (AS) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the Board.

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

Important notice

Purpose of this report

This report has been prepared in connection with our audit of the consolidated financial statements of NHS Orkney (the 'Board'), prepared in accordance with International Financial Reporting Standards ('IFRSs') as adapted by the Annual Accounts Manual, as at and for the year ended 31 March 2024. This report summarises the key issues identified during our audit but does not repeat matters we have previously communicated to you.

Limitations on work performed

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's Code of Audit Practice ("the auditing Code").

This report is for the benefit of NHS Orkney and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries").This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice. We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

Status of our audit

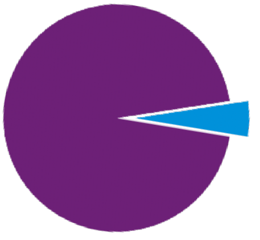
Our audit is not complete.

Materiality Group and Board

Total expenditure (2022/23)

£123m

(2021/22: £127m)



Materiality

£2.5m

2% of expenditure

(2022/23: £2.5m, 2% of expenditure)

£125k

Misstatements reported to the Audit and Risk Committee (2022/23: £125k)

£1.87m

Procedure designed to detect individual errors at this level (2022/23: £1.6m)

£2.5m

Materiality for the financial statements as a whole (2022/23: £2.5m)

Our materiality levels

We determined materiality for the consolidated financial statements at a level which could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. We used a benchmark of gross expenditure (as reported in 2022/23) which we consider to be appropriate as it reflects the scale of the Board's services and we consider this most clearly reflects the interests of users of the Board's accounts. To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of performance materiality £1.87m. We also adjust this level further downwards for items that may be of specific interest to users for qualitative reasons.

Group materiality vs other metrics

	2023/24	2022/23
Total assets	2.5%	3%

Our audit findings

Significant audit risks	Risk Change	Findings (Pages 8-11)
Valuation of Land & Buildings	No Change	We have reviewed the data, assumptions and methodology involved in managements' valuation of land and buildings. We have not identified any issues based on our work performed.
Fraud risk from expenditure recognition	Risk is now rebutted	We have updated our risk assessment and rebutted the fraud risk from expenditure recognition.
Management override of controls	No Change	We have not identified any instances of management override of controls based on our work performed.
Key accounting estimates	**Judgement**	**Findings (Page 12)**
Valuation of Land & Buildings	Optimistic	We have reviewed the data, assumptions and methodology involved in managements' valuation of land and buildings. We have not identified any issues based on our work performed.

Key audit matters
We set out above those areas which we considered to be key audit matters, in this case, valuation of land & buildings. The reason, response and related disclosures are summarised within the detail of this report.

Wider scope (Pages 15-22)
Under the Code of Audit Practice we are required to consider the areas defined in the Code of Audit Practice (2021) as wider-scope audit. We are required to provide clear judgements and conclusions on the effectiveness and appropriateness of the arrangements in place based on the work that we have done. Where significant risks are identified we will make recommendations for improvement. We have noted our recommendations on pages 29 and 30.

Consolidation schedules (Page 14)
We intend to issue an unqualified Group Audit Assurance Certificate to Audit Scotland regarding the Consolidation schedules submission, made through the submission of the summarisation schedules to Scottish Government.

Our audit findings

Corrected Audit Misstatements	Page 35	
Understatement/ (overstatement)	**£m**	**%**
Revenues	-	-
Expenditure	-	-
Total assets	4.54	4.3
Total liabilities	-	-
Reserves	4.54	4.9

Number of Control deficiencies	Pages 26-34
Significant control deficiencies	1
Other control deficiencies (including prior year outstanding)	5
Prior year control deficiencies remediated	4

Cautious Neutral Optimistic

Audit risks and our audit approach

Valuation of land and buildings

Significant audit risk

Risk: The carrying amount of revalued Land & Buildings differs materially from the fair value

Land and buildings are required to be held at fair value. As hospital buildings are specialised assets and there is not an active market for them they are usually valued on the basis of the cost to replace them with a 'modern equivalent asset'.

The value of the Board's land and buildings at 31March 2023 was £86.1 million.

All land and buildings were revalued by an independent valuer, Gerald Eve, as at 31 March 2023 on the basis of fair value (market value or depreciated replacement costs where appropriate). The net impact was an increase of £20.737 million.

Update since audit planning:

The Board has applied indexation to value the Board's land and buildings at 31 March 2024. As a result we have updated our audit response since the production of the audit plan.

Our response

We performed the following procedures designed to specifically address the significant risk associated with the valuation:

Control design:

- We evaluated the design and implementation of controls in place for management to review the valuation and the appropriateness of assumptions used;

Assessing the valuer's credentials:

- We critically assessed the independence, objectivity and expertise of Gerald Eve, the valuers used in developing the valuation of the Board's properties as at 31 March 2024;
- We inspected the correspondence with the valuers for the valuation of land and buildings to verify they are appropriate to produce a valuation consistent with the requirements of the Government Financial Reporting Manual (FReM);

Input assessment:

- We assessed the correspondence with the valuers in relation to the development of the valuation;

Assessing methodology and benchmarking assumptions:

- We challenged the appropriateness of the valuation of land and buildings; including any material movements from the previous revaluations. We challenged key assumptions within the valuation, including the use of relevant indices and assumptions of how a modern equivalent asset would be developed, as part of our judgement;
- We performed inquiries of the valuers in order to verify the methodology that was used in preparing the valuation and whether it was consistent with the requirements of the RICS Red Book and the FReM;

(Continued)

Cautious Neutral Optimistic

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Our response (continued)

- We agreed the calculations performed of the movements in value of land and buildings and verified that these have been accurately accounted for in line with the requirements of the FReM;
- We reviewed the output prepared by the Board’s valuers to confirm the appropriateness of the methodology utilised; and

Assessing transparency:

- Disclosures: We considered the adequacy of the disclosures concerning the key judgements and degree of estimation involved in arriving at the valuation.

Our findings

We have reviewed the data, assumptions and methodology involved in management’s valuation of land and buildings and confirmed these were appropriate for the estate.

We identified an adjustment in relation to application of the impact of the indexation which is highlighted in appendix 3.

Auditing standards require Auditors to identify a management review control where there is a significant audit risk. In the case of the valuation of land and buildings risk we have not been able to identify a control that meets the strict criteria of a management review control. We have not raised a formal control observation as the Board consider its existing controls to be proportionate to address the associated risk. However, as the valuation is associated with a significant risk, we are required to bring this matter to your attention.

Audit risks and our audit approach

Fraud risk from expenditure recognition - completeness

Significant audit risk

Risk: Liabilities and related expenses for purchases of goods or services are not completely identified and recorded

In the audit plan we reported that:

As achieving a breakeven position along with target savings against the Board's Core Revenue Resource Limit (RRL) is a key target, there is a risk that non-pay expenditure, may be manipulated in order to report that the target position has been met.

The setting of a savings target can create an incentive/ pressure for the management to understate the level of non-pay expenditure compared to that which has been incurred.

We consider this would be most likely to occur through understating accruals at the year end, for example to push back expenditure to 2024-25 to mitigate financial pressures.

Updated risk assessment

We note the Board has been reporting it would not breakeven through the majority of the financial year. The level of this overspend has not materially altered through the financial year. The financial statements show a breakeven position has been achieved, because the Board was provided with an additional allocation of £5.2m after the year end. The Board has reported in the Annual Report that the breakeven target has only been achieved as a result of this additional allocation.

Given the above, the incentive/pressure for management the understate the level of non-pay expenditure to that which has been incurred no longer exists and therefore we have rebutted the fraud risk from expenditure recognition.

In doing so, we have considered if there are any other factors that give rise to a significant or fraud risk from expenditure recognition and not identified any others.

Audit risks and our audit approach

Management override of controls

Significant audit risk

The risk

Professional standards require us to communicate the fraud risk from management override of controls as significant.

Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

We have not identified any specific additional risks of management override relating to this audit.

Our response

— Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we evaluated the design and implementation and, where appropriate, tested the operating effectiveness of the controls in place for the approval of manual journals posted to the general ledger to ensure that they are appropriate;

— We analysed all journals through the year and focused our testing on those with a higher risk;

— We assessed the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates;

— We reviewed the appropriateness of the accounting for significant transactions that are outside the Board's normal course of business, or are otherwise unusual; and

— We assessed the controls in place for the identification of related party relationships and tested the completeness of the related parties identified. We verified that these have been appropriately disclosed within the financial statements.

Our findings

—We identified journal entries and other adjustments meeting our high-risk criteria and have not identified any issues based on our examination.

—We evaluated accounting estimates and although the management position is optimistic, we did not identify any indicators of management bias. See page 12 for further discussion.

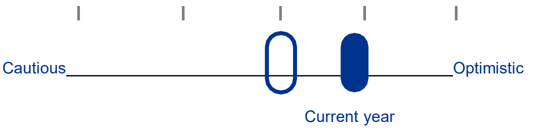
—We did not identify any significant unusual transactions.

—We did not identify any issues from our related parties testing. We have raised a control recommendation around the process to ensure completeness of identified related partis and associated transactions.

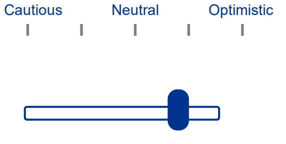
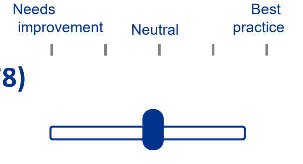
—We have noted control recommendation 2 in relation to segregation of duties with respect to processing of journals.

Key accounting estimates – Overview

Our view of management judgement



Our views on management judgments with respect to accounting estimates are based solely on the work performed in the context of our audit of the financial statements as a whole. We express no assurance on individual financial statement captions. Cautious means a smaller asset or bigger liability; optimistic is the reverse.

Asset/liability class	Our view of management judgement	Balance (£m)	YoY change (£m)	Our view of disclosure of judgements & estimates	Further comments
Assets Valuation of land & buildings		4.54	(16.78)		Assumptions were found to be optimistic.

Other estimates

We have also reviewed the following non-significant estimates as part of our audit work

- Depreciation
- Clinical and Medical provision and Clinical Negligence and Other Risks Indemnity Scheme (CNORIS) provision

Group involvement – significant component audits

Involvement in group components

The Group financial statements are made up of the following components:

- NHS Orkney (parent)
- Orkney Health Board Endowment Funds (Subsidiary)
- Orkney Integrated Joint Board (Joint Venture)

As communicated in our audit plan we determined that the parent Board was the only significant component. We have performed risk assessment procedures over the remaining components in order to confirm that there were not material balances within the other entities that could cause a material error and did not identify any exceptions.

We did not identify any errors as a result of the procedures set out above.

Other significant matters

Annual report

We have read the contents of the Annual Report (including the Accountability Report, Directors Report, Performance Report and Annual Governance Statement (AGS)) and audited the relevant parts of the Remuneration Report. We have checked compliance with the Annual Accounting Manual. Based on the work performed:

- We have not identified any inconsistencies between the contents of the Accountability, Performance and Director's Reports and the financial statements.
- We have not identified any material inconsistencies between the knowledge acquired during our audit and the director's statements. As Directors you confirm that you consider that the annual report and accounts taken as a whole are fair, balanced and understandable and provide the information necessary for patients, regulators and other stakeholders to assess the Board's performance, business model and strategy;
- The parts of the Remuneration Report that are required to be audited were all found to be materially accurate (in our work to date, however this is ongoing at the time of writing);
- The AGS is consistent with the financial statements and complies with relevant guidance; and
- The report of the Audit and Risk Committee included in the Annual Report includes the content expected to be disclosed as set out in the Annual Accounting Manual and was consistent with our knowledge of the work of the Committee during the year.

Consolidation schedules

As required by the Audit Code of Practice we are required to provide a statement on your consolidation schedule. We comply with this by checking that your summarisation schedule is consistent with your annual accounts. We have completed that work and found no matters to report.

Independence and Objectivity

ISA 260 also requires us to make an annual declaration that we are in a position of sufficient independence and objectivity to act as your auditors, which we completed at planning and no further work or matters have arisen since then.

Audit Fees

The fee for the audit was £96,940 in 2023/24 and £91,420 in 2022/23 (Source: Audit Scotland). Although we have identified experienced some delays and this will result in overruns we will agree with the Board. We have not completed any non-audit work at the Board during the year.

National Fraud Initiative

We completed our work on the NFI return in February 2024 and we rated the Board's engagement in the NFI exercise as amber. There was a lack of initial progress due to capacity issues and we also recommended regular reporting to the relevant committee of the Board.

Wider Scope

Appointed auditors are required to consider the areas defined in the Code of Audit Practice (2021) as wider-scope audit.

Auditors should consider these additional requirements when:

- identifying significant audit risks at the planning stage
- reporting the work done to form conclusions on those risks
- making recommendations for improvement and, where appropriate, setting out conclusions on the audited body's performance.

The new Code of Audit Practice brought in from 2022/23 has refreshed the areas used to define the wider audit scope. The previous 2016 edition set out four areas (described as audit dimensions), i.e. financial management, financial sustainability, governance and transparency, and value for money.

The new Code no longer uses the term audit dimensions, but it retains the areas of financial management and financial sustainability (though redefines each area) and replaces the other two as follows:

- governance and transparency dimension has been replaced with vision, leadership and governance area
- value for money dimension has been replaced with use of resources to improve outcomes.

Commentary on arrangements

We have prepared our commentary on the Board's Wider Scope arrangements within this report.

- Financial Management – Page 16;
- Financial Sustainability – Page 18;
- Vision, Leadership and Governance – Page 20; and
- Use of Resources to Improve Outcomes – Page 22

Wider Scope arrangements

Financial Management

Scope

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

Areas of Focus

- the arrangements to ensure effective systems of internal control, to ensure public money is applied within the relevant financial rules;
- the effectiveness of the budget control system to communicate accurate and timely financial performance to meet the needs of the user;
- the accuracy and embeddedness of financial forecasting within financial management and financial reporting arrangements, including achievement of financial targets;
- the arrangements taken to link budget setting, savings plans to the priorities and risks of the Board; and
- the capacity and skills of the Board's finance team.

Findings

Context

During the year 2023/24, NHS Orkney was moved from level one to three of the NHS Scotland Support and Intervention Framework, which is the first stage of formal escalation, due to significant deviation from the organisation's Financial Plan for 2023/24. This has meant the Board has received enhanced national monitoring and support.

Financial performance

For 2023/24 NHS Orkney had an allocated core revenue budget of £77.5 million with a planned deficit of £3.0 million. The Health Board was required to deliver £3.8m of efficiency savings during 2023/24 to achieve the £3.0m deficit plan. The total expenditure reported against this budget was £82.7 million, resulting in an overall overspend against the core allocation of £5.2 million which exceeds the budgeted overspend by £2.2 million. The overspend mainly relates to overspending in relation to supplementary staffing resulting from increased use of nurse agency and medical locums as compared to the planned trajectory.

We recognise the Board identified these pressures during the year and was accurately reporting these to Board. As part of our audit we have seen evidence of regular budget monitoring in relation to financial targets through presentation of financial performance reports to the Board on a periodic basis.

The Board has received £5.2m of repayable brokerage from Scottish Government to support the overspend during 2023/24 resulting in a balanced position being reported within the Accounts. This brokerage is repayable to Scottish Government on the Board returning to financial balance.

Wider Scope arrangements

Financial Management

Savings performance

Total savings of £3.8m have been recorded during the year, however only £0.9m (24%) of these savings were delivered recurrently, with £2.9m (76%) delivered on a non-recurrent basis which creates a recurrent pressure for the Board in future years.

To help ensure similar issues do not arise in 2024/25 the Board has replaced its Grip and Control arrangements which it implemented for 2023/24 and replaced these with new arrangements including the Improving Efficiency Together arrangements.

Finance team capacity

A rapid review of the finance team was carried out in February 2024 following NHS Orkney's escalation to level three of the NHS Scotland Support and Intervention Framework which requires 'significantly enhanced' support and scrutiny of operations and performance. A number of recommendations were noted based on the review which included:

- Consideration of a re-structure of the finance team. Re-structure to include benchmarking the size, grades and responsibilities of team with a similar organisation.
- Investment in training and development across the finance team.

We understand the Board has paused implementing these until later into the financial year.

Conclusions

We are satisfied the Board's financial monitoring and reporting arrangements are adequate as an accurate financial position has been identified and reported during the year. However there was a significant weakness in achieving their in year financial plan without the unplanned financial support received from Scottish Government, which points to arrangements to successfully managing the financial position not operating effectively during the year. This has also been an issue in previous years.

The Board has implemented changes to its arrangements regarding financial management with the support provided from it being escalated to level three of the NHS Scotland Support and Intervention Framework The Board now need to embed these arrangements taking appropriate actions where arrangements are not delivering the desired outcome in a timely manner.

The Board has recognised capacity issues within the finance team and implemented a review, it now needs to implement actions to address the findings.

Wider Scope arrangements

Financial sustainability

Scope

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

Areas of Focus

•the arrangements in place to balance any short-term financial challenges and cashflow requirements and longer term financial sustainability

•the arrangements to ensure any recovery plan is fully integrated to deliver the Boards priorities.

•the arrangements put in place to address any identified funding gaps / savings plans and organisational restructures, including clarity of the impact on services to the public

•the degree to which medium to longer term capital financial plans include clear links to how capital investment will be used to deliver organisational priorities, including revenue consequences of the capital expenditure.

Findings

Historical performance

In the Financial Management section of this report we identified the Board had an overspend of £5.2m, which was met through additional unplanned funding from Scottish Government to enable the Board to breakeven. We note in both 2022/23 and 2021/22 similar funding was required from Scottish Government (£4.1m and £4.7m respectively for 2022/23 and 2022/21).

Financial plan 2024/25

The financial budget for 2024/25 was included in the three year financial plan submitted to the Scottish Government. The revenue resource limit for 2024/25 amounts to £76.9 million. Additional support in the form of repayable brokerage is available from the Scottish Government which is capped at £0.99m for NHS Orkney.

The Board approved and submitted a final deficit financial plan of £5.8m for 2024/25, excluding any brokerage support. The plan outlines the total deficit before savings of £9.8 million for 2024/25. A savings target of £4 million has been included for 2024/25 in the financial plan.

Savings plans for 2024/25

The Board has identified schemes to support the savings target amounting to £3.4 million. The major schemes identified include: Workforce £1.3 million; Social Care and community £0.7 million; Diagnostics £0.6 million; Pharmacy £0.3 million; and Procurement £0.2 million. These schemes have been identified using the Board's Improving Efficiency Together initiative.

Wider Scope arrangements

Financial sustainability

We note that the identified saving plans above have been risk assessed. Out of the total amount of savings amounting to £3.4 million, £2.7 million have been assessed as low risk, £0.5 million as medium risk and £0.1 million as high risk. In addition we are aware the Board have further savings amounting to £0.5 million in the pipeline.

We note the Board has historically struggled to deliver savings and going forward the Board has developed its Improving Efficiency Together initiative to help ensure savings are delivered.

Three year financial plan

The Board approved the 3 year financial plan on 25 April 2024. We have reviewed the financial plan and arrangements in place to ensure any short term financial challenges and longer term financial sustainability objectives are achieved. We have reviewed the extent to which any savings plans have been developed and the Board arrangements in place to deliver these. The three year financial plan highlights a cumulative deficit amounting to £25.8 million. The plan further proposes cumulative savings amounting to £9.5 million resulting in a cumulative financial deficit, after the proposed savings, amounting to £16.3 million.

Conclusions

Based on historical performance the Board has a significant weaknesses in its arrangements to achieve financial sustainability. These weaknesses are also apparent in its three year plan, where there is a cumulative deficit amounting to £16.3m after proposed savings. Without further savings the Board is not financially sustainable.

The implementation of the identified savings as well as development of un-identified savings plan represents a significant challenge, and despite there being schemes planned for 2024/25 there is a potential risk that the planned savings will not be achieved due to the current pressures faced by the Board. As mentioned in the financial management section, the Board has implemented changes to its arrangements regarding financial management with the support provided from it being escalated to level three of the NHS Scotland Support and Intervention Framework The Board now need to embed these arrangements taking appropriate actions where arrangements are not delivering the desired outcome in a timely manner.

Wider Scope arrangements

Vision, Leadership and Governance

Scope

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

Areas of Focus

•the vision and strategy of the Board, to ensure it includes a clear set of priorities which reflects the pace and depth of improvement that is need to realise the Boards priorities and long term sustainability of services to meet the needs of the citizens

• the governance arrangements are appropriate and operating.

•assess the level of involvement of the local communities, including seldom heard groups, and health inequalities in identifying and agreeing the Boards priorities.

•assess the evidence that demonstrates leaders are adaptive to the changing environment

•the culture of the Board and how it operates with partners to understand their roles and responsibilities to help deliver the priorities of all partners, including where delivered through ALEO's

Findings

Corporate Strategy

In previous years, the Board revisited its plans and priorities, and issued a Plan on a Page. In April 2023, the 2023 Plan on a Page was reviewed and agreed by the Board, which sets out the priorities of NHS Orkney for 2023/24. Key priorities identified as part of the plan were Workforce, Culture, Quality and Safety, System and Governance and Sustainability.

The 2023/24 Annual Delivery Plan (ADP) which set out our priorities for 2023/24 - aligned to the Plan on a Page - was approved by the Board. We noted that regular progress updates were presented to the Board in relation to the annual delivery plan.

We note that the new corporate strategy for 2024-28 was presented to the Board for approval in April 2024, following which it has been published on the Board's website for public access. 5 strategic objectives have been identified as part of the corporate strategy which includes:

- People;
- Patient safety, quality and care
- Performance
- Potential; and
- Place

Wider Scope arrangements

Vision, Leadership and Governance

Findings

The corporate strategy further identifies metrices for delivery against each of the strategic objectives identified in the corporate strategy.

We noted that the development of the corporate strategy was informed by consultation and engagement which included consultation with community and staff.

We further noted, based on the update provided to the Board dated 25th April 2024, that further work is underway to build the new strategic objectives into the governance and assurance systems. This includes development of new Board Assurance and Risk Management framework, alignment of the integrated performance reporting to new strategic objectives and development of the underlying workplans.

Underlying workplans being developed include workplans related to digital and information, estates, people and financial categories. Further a refresh of the clinical strategy is planned to ensure alignment with the corporate strategy.

Risk register

An updated risk register has been approved in December 2023 by the Board and published on the website for public access. We also noted evidence of updates being provided to the Board in relation to the up to date status of risk register as part of periodic Board meetings.

Internal Audit

We have noted evidence of operation of an internal audit function with regular updates to the audit and risk committee in relation to progress reporting against the approved internal audit plan and status of recommendations from the internal audit.

Conclusion

We have not identified any significant risks or significant weaknesses relating to vision, leadership and governance.

Wider Scope arrangements

Use of Resources to Improve Outcomes

Scope

Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

Areas of Focus

•the arrangements in place to demonstrate that there is a clear link between money spent and outputs and the outcomes delivered

•the arrangements in place to assess whether outcomes are improving based on the trend and relative to pace of change in comparable organisations, and appropriate to the risk and challenges facing the Board

•the arrangements in place to consider cost of delivery of current services and whether alternative models of service delivery been considered.

•the arrangements to evaluate service delivery and quality and whether the user needs and views are included in any such evaluation.

Findings

A new integrated performance report was introduced from October 2023 to strengthen the reporting and governance process.

Integrated Performance Reports were produced and reported to Board on an ongoing basis, which shows that performance is appropriately reported and monitored.

We have noted that the reporting categories under the integrated performance report are aligned with the strategic objectives identified as part of plan on the page which acts as the strategy document for 2023/24.

We noted the integrated performance report makes use of quantitative and qualitative data and expands on the noted trends through commentary to provide a basis for informed decision making. We also noted evidence of inclusion of external benchmarking to allow comparison with peer organizations.

As noted in the vision, leadership and governance section, work is underway to align the integrated performance reporting to the newly developed and approved corporate strategy.

Measures taken under this category feed into the statutory duty in relation to maintaining arrangements to secure best value.

Conclusion

We have not identified any significant risks or significant weaknesses relating to use of resources to improve outcomes.

Appendices

Contents	Page

Mandatory communications

Type		Statement
Our draft management representation letter	OK	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2024.
Adjusted audit differences	OK	Appendix 3 identifies 1 adjusted audit differences.
Unadjusted audit differences	OK	No unadjusted audit differences
Related parties	OK	There were no significant matters that arose during the audit in connection with the entity's related parties apart from the recommendation on page 28.
Other matters warranting attention by the Audit and Risk Committee		There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies		We communicated to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated in writing.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts		No actual or suspected fraud involving group management, employees with significant roles in internal control, or where fraud results in a material misstatement in the financial statements was identified during the audit.

Mandatory communications

Type		Statement
Significant difficulties	OK	No significant difficulties were encountered during the audit.
Modifications to auditor's report	OK	None.
Disagreements with management or scope limitations	OK	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information	OK	No material inconsistencies were identified relating to other information in the annual report, Strategic and Directors' reports. The Annual report is fair, balanced and comprehensive, and complies with the Annual Reporting Manual.
Breaches of independence	OK	No matters to report. The engagement team have complied with relevant ethical requirements regarding independence.
Accounting practices	OK	Over the course of our audit, we have evaluated the appropriateness of the Board's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate.
Significant matters discussed or subject to correspondence with management	OK	The significant matters arising from the audit were discussed, or subject to correspondence, with management.
Provide a statement to AS on your consolidation schedule	OK	We will issue our report to Audit Scotland following the signing of the annual report and accounts.

Recommendations raised and followed up

The recommendations raised as a result of our work in the current year are as follows

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
1	❷	**Accounts preparation - Issue** As per the year end timetable, we were anticipating receiving the financial statements on 7 May 24. however, we did not receive a version of the financial statements that mapped to a trial balance and full transaction list until a later date. Following this there were number of version updates. We further note that the financial statements required further updates to be aligned to the latest annual accounts manual and template. Although we do recognise management have struggled with capacity due to absences in the Finance Team. **Risk** There is a risk that the deadline for submitting signed annual report and accounts is not met due to delays in receiving information. **Recommendation** We recommend that management revisit its accounts preparation plan in advance for 2024/25 to ensure arrangements are updated, including revising timelines (if required) to ensure its accounts preparation plan is appropriate. We recommend this is completed in-conjunction with reviewing external audit working paper requirements therefore enabling the audit to start on a more timely basis.	As indicated, the Board have had significant leadership and capacity constraints in the finance team during the production of the annual accounts. It should also be noted that whilst there were some minor delays to the timetable, this was primarily due to issues outside of the team's control including delays to allocations and other external support required to address issues with submission templates. We do acknowledge however that further internal improvements can be made which will be addressed and included within the accounts timetable and planning process for future years. **Completion Date:** 31 March 2025

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
2	❷	**Journals segregation of duties - Issue** From inquiry of management and our journals walkthrough we identified that users of the general ledger have the ability to post and approve their own journals within their own authorisation limits. **Risk** There is a risk that there is no segregation of duties. Whilst senior members of the finance team may perform review of journals, this is not fully documented. **Recommendation** We recommend that management implement a fully documented review of any journals posted and approved by the same user.	We acknowledge the recommendation. It should be noted however that this is partly linked to the leadership and capacity constraints within the team and also the challenges of working within a very small Island Board finance team. However, we will review this with the aim of introducing a streamlined process to ensure segregation of duties and appropriate authorisation levels. **Completion Date:** 30 September 2024

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
3	2	**Related parties** Auditing standards require us to obtain an understanding of related party processes and controls that: • identify all related parties, relationships and transactions • authorize and approve significant related party transactions and arrangements; and • account for and disclose all related party relationships and transactions in the financial statements. We are satisfied management have a process in place to request related parties through receipt of declarations of interest (DoI) from all members of the Board, and then an exercise is carried out where by finance search all the ledger to identify transactions with said related parties at the year end. The Board consider its existing controls to authorise and approve all significant related party transactions be proportionate to the address the associated risk. These transactions continue to be closely scrutinised, albeit retrospectively, and corrective actions will be implemented if deemed appropriate. However, with respect of identifying related parties and transactions, management did not undertake the search on the AP/AR ledger until after the year end, increasing the risk of incomplete disclosure. In addition, management does not carry out a completeness check which verifies all interests have been declared. **Recommendation** We recommend the search on the AP/AR ledger should take place before the audit fieldwork commences. In addition, management should search all Board members (including close family and dependents) on Companies House at the year end to ensure completeness of the declarations made. .	We acknowledge the recommendation and will build this into the workplan and the future annual accounts timetable. **Completion Date:** 31 December 2024

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
4	2	**Wider scopes – Financial Management** The Board has carried out a rapid review of the finance team following the Board's escalation to level three of the NHS Scotland Support and Intervention Framework. The review has identified a number of recommendations. We understand the Board has paused implementing these until later into the financial year. **Recommendation** The Board should consider the recommendations made in the rapid review and implement where appropriate to address the issues identified in the rapid review.	This improvement programme and associated action plan will be developed from quarter 1 of the 2024/25 financial year with a clear prioritisation, timescale and resource plan. Progress and assurance of the improvement programme will be shared with the Boards Finance and Performance Committee throughout the year **Completion Date:** 31 March 2025

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
5	❶	**Wider Scopes – Financial management and sustainability** Our work in relation to wider scopes has identified significant weaknesses in the Board's arrangements to achieve in year financial balance without unplanned financial support from Scottish Government. Further to this, based on historical performance the Board has a significant weaknesses in its arrangements to achieve financial sustainability. These weaknesses are also apparent in its three year plan, where there is a cumulative deficit amounting to £16.3m after proposed savings. Without further savings the Board is not financially sustainable. We recognise during the course of the financial year the Board has implemented changes to its arrangements regarding financial management with the support provided from it being escalated to level three of the NHS Scotland Support and Intervention Framework The Board now need to embed these arrangements taking appropriate actions where arrangements are not delivering the desired outcome in a timely manner. **Recommendation** The Board now need to embed the changes it has introduced to its financial management/sustainability arrangements taking appropriate actions where arrangements are not delivering the desired outcome in a timely manner. .	The Board will ensure the changes and improvement programme are embedded across the organisation taking appropriate actions where arrangements are not delivering the desired outcome in a timely manner. **Completion Date:** 31 March 2025

Recommendations raised and followed up (continued)

We have followed up the recommendations raised in the prior year by Audit Scotland. Below is a table of the actions and implementation. We have disclosed below the recommendations that are still ongoing with the current management response.

Priority rating for recommendations					
❶	**Priority one:** issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	❷	**Priority two:** issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸	**Priority three:** issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

Total number of recommendations	Number of recommendations implemented or superseded with new recommendations	Number outstanding (repeated below):
5	3	2

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date/Status
1	❷	The Scottish Government Clinical Prioritisation Framework performance is monitored through returns to the Scottish Government. Those charged with governance do not regularly see the returns. Risk – There is a risk that key performance issues are not subject to appropriate scrutiny. Recommendation In order to improve transparency over performance the monitoring information on the clinical prioritisation framework should be periodically presented to the appropriate committee.	**Agreed:** To be captured as part of NHS Orkney's Annual Delivery Plan for 2023/24 Responsible Officer Medical Director **Date:** 31 March 2024 **Status 17 June 2024:** To be confirmed

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
2	❸	**Review of IT Equipment and Intangible Assets – Issue** We have identified a small number of Intangible Assets held in the Asset Register that were no longer in use. **Risk** There is a risk assets are categorised incorrectly in the financial statements and/or asset lives are not appropriate. **Recommendation:** An annual process needs to take between Finance and IT to review the Fixed Asset Register for both physical IT equipment and Intangible Assets to ensure that all assets classified as operational assets are still in use.	**Agreed:** Process will be implemented in 2023/24 by Head of IT and Head of Finance. **Date:** 31 March 2024 **Status 17 June 2024:** Implemented
3	❸	**Impairment review - Issue** There is no documented impairment review completed by management with estates involvement. **Risk** There is a risk that property, plant and equipment is overstated if there are impairment indicators that have not been identified and reviewed. **Recommendation** We recommend that management complete an annual impairment review with estates involvement, that is formally evidenced and approved.	**Agreed:** Process will be implemented in 2023/24 by Head of Estates, Facilities and NPD Contract, and Head of Finance. **Date:** 31 March 2024 **Status 17 June 2024:** Implemented

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
4	❸	**Key estimates and judgements - Issue** The financial statements contain a number of key estimates and judgements, which if not appropriately applied can lead to significantly different entries in the financial statements. Those charged with governance have not had an opportunity to consider the proposed accounting policies, key judgements and estimates ahead of the preparation of the financial statements. **Risk** Whilst we acknowledge that the accounting policies went to Audit Committee in May 2023, we have not been able to identify where Board or Audit Committee consider these before the preparation of the financial statements (prior to 31 March). **Recommendation** We would recommend that management produce annual papers for Board or Audit Committee discussion and approval setting out their approach to key judgements and estimates, for example going concern and valuation of property plant and equipment, prior to the preparation of the financial statements commences.	**Agreed:** Director of Finance will take an annual paper to the Risk and Audit Committee in March. **Date:** 31 March 2024 **Status 17 June 2024:** Implemented

Recommendations raised and followed up (continued)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
5	❶	**Wider Scope findings** Our Wider Scope findings have identified a weakness impacting on the Board's arrangements in respect of Use of Resources to Improve Outcomes. **Recommendation** We recommend that aligned to five pillars set out in the Plan on a Page 2023/24 that the following arrangements are clearly developed and implemented by the Board: • Clear SMART targets are identified to measure achievement of the outcomes of the Board's Plan on a Page; and • Performance indicators need to be aligned to the SMART targets to allow the Board to monitor achievement of the outcomes.	**Agreed** Work is ongoing in this area and is being led by the Chief Executive and the Planning, Performance, and Risk Manager. **Date:** 31 March 2024 **Status 17 June 2024:** Implemented

Audit Differences

Under UK auditing standards (ISA (UK) 260) we are required to provide the Audit and Risk Committee with a summary of **unadjusted audit differences** (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. In line with ISA (UK) 450 we request that you correct uncorrected misstatements. However, they will have no effect on the opinion in our auditor's report, individually or in aggregate. As communicated previously with the Audit and Risk Committee, details of all adjustments greater than £125k will be communicated. To date, we have not identified any unadjusted audit differences.

Under UK auditing standards (ISA (UK) 260) we are required to provide the Audit and Risk Committee with a summary of **adjusted audit differences** (including disclosures) identified during the course of our audit. The adjustments to date below have been included in the financial statements.

Adjusted audit differences (£'000s)

No	Detail	SOCNE Dr/(cr)	SOFP Dr/(cr)	Comments
1	Cr Gain on revaluation of PPE	-	(4,540)	The draft accounts did not include the correct revaluation adjustment emanating from the indexation provided by the valuer. The correct amounts are stated here.
	Dr Property, plant and equipment - revaluations	4,765	-	The accounts also did not include an entry for the gain on revaluation of PPE in the Other Comprehensive Net Expenditure section of the Statement of Comprehensive Net Expenditure
	Cr Property, plant and equipment – accumulated depreciation	-	(225)	
Total		4,765	(4,765)	

Audit Differences

We also identified a number of disclosure adjustments, the most significant of which are as follows:

- Inconsistencies in the accounting policies description as compared to the latest annual accounts manual and templates including newly effective standards, narrative in relation to estimates and updates in relation to the related parties note.
- Multiple updates were required to the information provided by the SPPA to arrive at the values to be disclosed in the remuneration report resulting in initially reported values requiring updates.

Intra-group error reporting

Further to the misstatements identified on page 35, we are required to report any identified errors in the reporting of intra-group balances with other NHS entities exceeding £200,000 as part of our reporting on the Consolidation Schedules to Audit Scotland. We have identified no inconsistencies on our report on the Consolidation Schedules.

Confirmation of Independence

We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.

To the Audit and Risk Committee members

Assessment of our objectivity and independence as auditor of the NHS Orkney.

Professional ethical standards require us to provide to you with a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard.

As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Independence and objectivity considerations relating to the provision of non-audit services

Summary of non-audit services

We have not provided any non-audit services in year.

Confirmation of Independence (continued)

We have considered the fees charged to the Board for professional services provided during the reporting period. Total fees charged can be analysed as follows:

Entity	2023/24	2022/23
Auditor Remuneration **	£109,440	£103,250
Pooled Costs	£13,230	£9,340
Audit Support Costs	-	£4,040
Sectoral Cap Adjustment	-£25,730	-£25,210
TOTAL AUDIT FEES (Incl VAT)	**£96,940**	**£91,420**

Source: Audit Scotland

Application of the FRC Ethical Standard 2019

We communicated to you previously the effect of the application of the FRC Ethical Standard 2019. That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

We confirm that as at 15 March 2020 we were not providing any non-audit or additional services that required to be grandfathered.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the Audit and Compliance Committee and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

KPMG's Audit quality framework

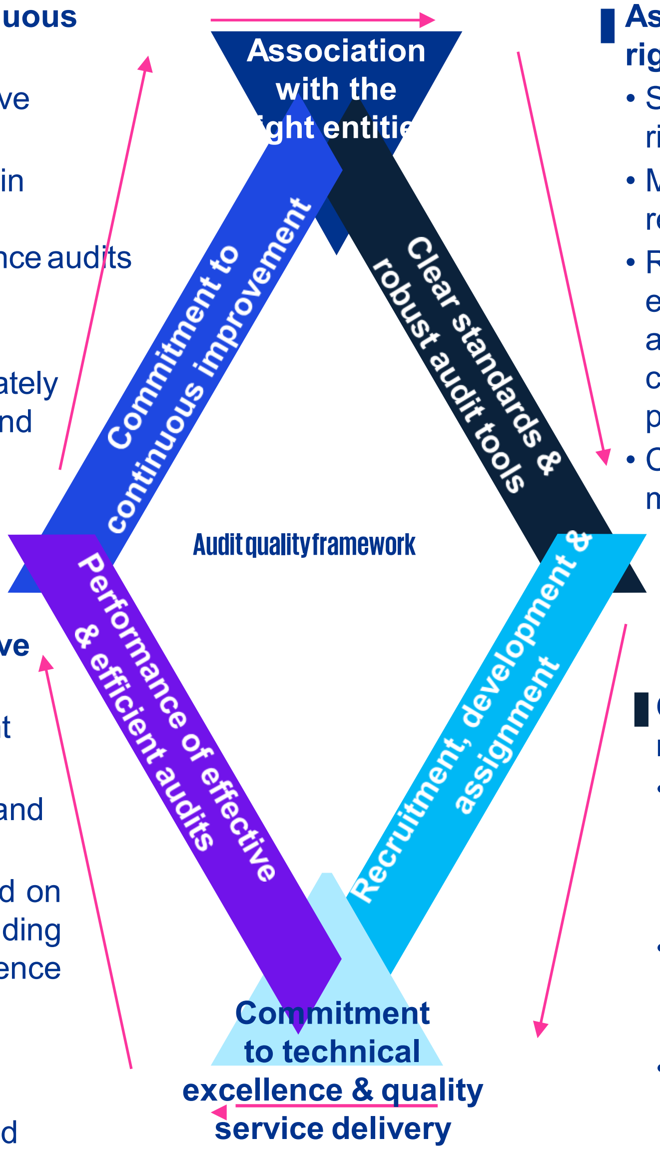
Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

- To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.
- Responsibility for quality starts at the top through our governance structures as the UK Board is supported by the Audit Oversight Committee, and accountability is reinforced through the complete chain of command in all our teams.

Appendix five (continued)

Commitment to continuous improvement

- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings



Association with the right entities

- Select clients within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management

Performance of effective & efficient audits

- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching, including the second line of defence model
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Insightful, open and honest two way communications

Clear standards & robust audit tools

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- KPMG Clara incorporating monitoring capabilities at engagement level
- Independence policies

Commitment to technical excellence & quality service delivery

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights

Recruitment, development & assignment of appropriately qualified personnel

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members employed KPMG specialists and specific team members

Appendix six

FRC's areas of focus

The FRC released their Annual Review of Corporate Reporting 2022/23 in October 2023. In addition, they have released three thematic reviews during the year should be considered when preparing reporting for the current financial period.

The reports identify where the FRC believes companies should be improving their reporting. Below is a high level summary of the key topics. We encourage management and those charged with governance to read further on those areas which are significant to the entity.

Reporting on the effects of inflation and other uncertainties

This year's Annual Review of Corporate Reporting identifies that companies continue to face significant economic and geopolitical uncertainty and annual report and accounts should therefore tell a coherent story about the impacts on the business and the assumptions the trust has made in preparing the financial statements.

The FRC notes that interest rate rises in response to persistent inflation, the related impact on consumer behaviour, and limited growth present a particularly challenging environment for companies. Financial reporting needs to set out the impact of these issues on their business, and the assumptions which underpin the values of assets and liabilities in financial statements. Significant changes in discount rates and future cash flows are expected as a result and they should be highlighted.

The impacts of uncertainty on companies' narrative reporting and financial statements are numerous, but the FRC sets out its clear disclosure expectations for 2023/2024:

- Disclosures about uncertainty should be sufficient to meet relevant requirements *and* for users to understand the positions taken in the financial statements.
- The strategic report should give a clear description of the risks facing the business, the impact of these risks on strategy, business model, going concern and viability, and disclosures should be cross-referenced to relevant detail in the report and accounts.
- Transparent disclosure should be provided of the nature and extent of material risks arising from financial instruments.

Preparers should take a step back to consider whether the annual report, as a whole, is clear, concise and understandable and whether additional information, beyond the requirements of the standards, is necessary to understand particular transactions, events or circumstances.

FRC's areas of focus (cont.)

Climate-related reporting

Climate-related reporting continues to progress with the new Companies Act requirements, effective for periods commencing 6 April 2022, requiring more entities to include climate-related financial disclosures within the annual report. These are largely aligned with the Taskforce on Climate-Related Disclosures (TCFD) recommendations, but do not include the 'comply or explain' provision for items that would have a material impact on the entity.

Climate-related risks remains an area of ongoing focus for the FRC as they embed the review of these disclosures into their routine annual reviews. The FRC has highlighted that it expects companies to provide improved disclosure explaining the linkage between narrative reporting on uncertainties such as climate change, and the assumptions made in the financial statements.

In respect of TCFD disclosures, the FRC notes that sustainability reporting requirements continue to evolve and companies are still at very different stages in their reporting in this area. The FRC expect in scope entities to provide a clear statement of consistency with TCFD which explains, unambiguously, whether management considers they have given sufficient information to comply with the framework in the current year. Companies must, in any case, comply with the new mandatory requirements for disclosure of certain TCFD-aligned information.

In relation to the specific thematic on metrics and targets they highlighted five areas of improvement:

- the definition and reporting of trust-specific metrics and targets, beyond headline 'net zero' statements;
- better linkage between companies' climate-related metrics and targets and the risks and opportunities to which they relate;
- the explanation of year-on-year movements in metrics and performance against targets;
- transparency about internal carbon prices, where used by companies to incentivise emission reduction; and
- better linkage between climate-related targets reported in TCFD disclosures and ESG targets disclosed in the Directors' Remuneration Report.

FRC's areas of focus (cont.)

Impairment of assets

Heightened economic uncertainty, high inflation and higher interest rates have resulted in more instances of impairment or reductions in headroom, prompting the need for more detailed disclosures under IAS 36. The FRC notes that many of the queries it has raised with companies in the past year would have been avoided by clearer, more complete disclosures.

Disclosures should provide key inputs and assumptions applied, along with relevant values and sensitivity information where impairments could arise from reasonably possible changes in assumptions.

Assumptions should be consistent with information provided elsewhere in the annual report and with the wider economic environment; where there are inconsistencies, these should be explained.

Discount rates should be consistent with the assumptions in the cash flow projections, particularly in respect of risk and the effects of inflation.

Judgements and estimates

Most of the FRC's queries related to estimation uncertainty, and often involved disclosures which either did not contain sufficient information to be useful, or which appeared inconsistent with disclosures given elsewhere.

Disclosures should explain the significant judgement and provide quantified sensitivities where there is a significant source of estimation uncertainty. This includes judgements relating to the going concern assessment and accounting for inflationary features, including the use of discount rates. Sensitivity disclosures should be meaningful for readers, remain appropriate in current circumstances, explaining significant changes in assumptions and the range of possible outcomes since the previous year.

The FRC highlights the need for disclosures to clearly distinguish between estimates with a significant risk of a material adjustment to carrying amounts within the next year, and other sources of estimation uncertainty.

Cash flow statements

Cash flow statements have again been an area where the FRC have raised many queries and it remains one of the most common causes of prior year adjustments. Most queries raised by the FRC relate to unusual or complex transactions which have not been appropriately reflected in the cash flow statement.

Companies should ensure that descriptions of cash flows are consistent with those reported elsewhere in the report and accounts, with non-cash investing and financing transactions being excluded, but disclosed elsewhere if material.

In addition, companies should ensure that cash flows are appropriately classified between operating, financing and investing, and cash flows should not be inappropriately netted. Cash and cash equivalents should comply with the relevant definitions and criteria in the standard.

FRC's areas of focus (cont.)

Strategic report and other Companies Act 2006 matters

Strategic reports should focus not only on financial performance but should also explain significant movements in the balance sheet and cash flow statement. They should articulate the effect of principal risks and uncertainties facing the business, including economic and other risks such as inflation, rising interest rates, supply chain issues, climate-related risks and labour relations.

In addition, the FRC reminds companies that they should comply with the legal requirements for making distributions and repurchasing shares including, where relevant, the requirement to file interim accounts to support the transaction.

Income taxes

Following their thematic review last year, the FRC reminds companies that the nature of evidence supporting the recognition of deferred tax assets should be disclosed, and should factor in any difficult economic environment.

Additionally, companies should ensure tax-related disclosures are consistent throughout the annual report, uncertain tax positions are adequately disclosed, and material reconciling items in the tax rate reconciliation are presented separately and appropriately described.

Financial instruments

Companies should ensure that the nature and extent of material risks arising from financial instruments (including inflation and rising interest rates), and related risk management, are adequately disclosed.

This includes disclosures being sufficient to explain the approach and significant assumptions applied in the measurement of expected credit losses, including concentrations of risk, and assessments should be reviewed and adjusted for forecast future economic conditions.

The effect of refinancing and changes to covenant arrangements should be explained, with information about covenants being provided unless the likelihood of a breach is remote.

Lastly, the FRC reminds companies that cash and overdraft balances should be offset only when the qualifying criteria have been met.

Revenue

Where variable consideration exists, companies should provide sufficient disclosure to explain how it is estimate and constrained.

Accounting policies and relevant judgement disclosures should be provided for all significant performance obligations. Those disclosures should address in sufficient detail the timing of revenue recognition, the basis for recognising revenue over time and the methodology applied.

Lastly, the FRC reminds companies that inflationary features in contracts with customers, and the accounting for such clauses, should be adequately disclosed and clearly explained.

FRC's areas of focus (cont.)

Presentation of financial statements and related disclosures

The FRC expects companies to disclose trust-specific information to meet the overall disclosure objectives of relevant accounting standards, and not just the narrow specific disclosure requirements of individual standards. They set out a clear expectation that additional information (beyond the minimum requirements of the standards) should be included where needed.

Provisions and contingencies

Clear descriptions of the nature and uncertainties for material provisions or contingent liabilities, the expected timeframe and the basis for estimating the probable or possible outflow should be provided.

Inputs used in measuring provisions should be consistent in the approach to incorporating inflation, and details of related assumptions should be provided.

Fair value measurement

Fair value measurement has returned this year as one of the FRC's top ten issues raised in their correspondence with companies, and this has been the topic of a thematic review. Common queries raised include the omission of sensitivity disclosures and the quantification of unobservable inputs into fair value measurements.

The FRC reminds companies that they should use market participants' assumptions, rather than their own, in measuring fair value.

Thematic reviews

During the year FRC has issued Thematic reviews on the following topics:

- Climate-related metrics and targets
- IFRS 13 Fair value measurement
- IFRS 17 Insurance contracts – Interim disclosures in the first year of application

2023/24 review priorities

The FRC has indicated that its 2023/24 reviews will focus on the following sectors which are considered by the FRC to be higher risk by virtue of economic or other pressures:

Travel, hospitality and leisure

Retail and personal goods

Construction materials

Gas, water and multi-utilities

ISA (UK) 315 Revised: changes embedded in our practices

Summary

In the prior period, ISA (UK) 315 Revised "Identifying and assessing the risks of material misstatement" was introduced and incorporated significant changes from the previous version of the ISA.

These were introduced to achieve a more rigorous risk identification and assessment process and thereby promote more specificity in the response to the identified risks. The revised ISA was effective for periods commencing on or after **15 December 2021**.

The revised standard expanded on concepts in the existing standards but also introduced new risk assessment process requirements – the changes had a significant impact on our audit methodology and therefore audit approach.

What impact did the revision have on audited entities?

With the changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities (and their governance structures) becoming more complicated, standard setters recognised that audits need to have a more robust and comprehensive risk identification and assessment mechanism.

The changes result in additional audit awareness and therefore clear and impactful communication to those charged with governance in relation to (i) promoting consistency in effective risk identification and assessment, (ii) modernising the standard by increasing the focus on IT, (iii) enhancing the standard's scalability through a principle based approach, and (iv) focusing auditor attention on exercising professional scepticism throughout risk assessment procedures.

ISA (UK) 315 Revised: changes embedded in our practices (cont.)

Implementing year 1 findings into the subsequent audit plan

Entering the second year of the standard, the auditors will have demonstrated, and communicated their enhanced insight into their understanding of your wider control environment, notably within the area of IT.

In year 2 the audit team will apply their enhanced learning and insight into providing a targeted audit approach reflective of the specific scenarios of each entity's audit.

Akey area of focus for the auditor will be understanding how the entity responded to the observations communicated to those charged with governance in the prior period.

Where an entity has responded to those observations a re-evaluation of the control environment will establish if the responses by entity management have been proportionate and successful in their implementation.

Where no response to the observations has been applied by entity, or the auditor deems the remediation has not been effective, the audit team will understand the context and respond with proportionate application of professional scepticism in planning and performance of the subsequent audit procedures.

What will this mean for our on-going audits?

To meet the on-going requirements of the standard, auditors will each year continue to focus on risk assessment process, including the detailed consideration of the IT environment.

Subsequent year auditor observations on whether entity actions to address any control observations are proportionate and have been successfully implemented will represent an on-going audit deliverable.

Each year the impact of the on-going standard on your audit will be dependent on a combination of prior period observations, changes in the entity control environment and developments during the period. This on-going focus is likely to result in the continuation of enhanced risk assessment procedures and appropriate involvement of technical specialists (particularly IT Audit professionals) in our audits which will, in turn, influence auditor remuneration.

ISA (UK) 240 Revised: changes embedded in our practices

Ongoing impact of the revisions to ISA (UK) 240

- ISA (UK) 240 (revised May 2021, effective for periods commencing on or after 15 December 2021*) The auditor's responsibilities relating to fraud in an audit of financial statements* included revisions introduced to clarify the auditor's obligations with respect to fraud and enhance the quality of audit work performed in this area. These changes are embedded into our practices and we will continue to maintain an increased focus on applying professional scepticism in our audit approach and to plan and perform the audit in a manner that is not biased towards obtaining evidence that may be corroborative, or towards excluding evidence that may be contradictory.
- We will communicate, unless prohibited by law or regulation, with those charged with governance any matters related to fraud that are, in our judgment, relevant to their responsibilities. In doing so, we will consider the matters, if any, to communicate regarding management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud.

Matters related to fraud that are, in our judgement, relevant to the responsibilities of Those Charged with Governance

Our assessment of the risks of material misstatement due to fraud may be found on pages 10-11. We also considered the following matters required by ISA (UK) 240 (revised May 2021, effective for periods commencing on or after 15 December 2021) *The auditor's responsibilities relating to fraud in an audit of financial statements* , to communicate regarding management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud:

- Concerns about the nature, extent and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.
- A failure by management to address appropriately the identified significant deficiencies in internal control, or to respond appropriately to an identified fraud.
- Our evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.

Based on our assessment, we have no matters to report to Those Charged with Governance.

Appendix nine

Newly effective accounting standards (and relevant IFRIC items)

Standards	Expected impact: High	Expected impact: Moderate	Expected impact: Low	Expected impact: None	Effective for years beginning on or after: 01 Jan 2023	Effective for years beginning on or after: 01 Jan 2024	Effective for years beginning on or after: 1 Jan 2025	Early adoption permitted
IFRS 17 Insurance Contracts, including amendments Initial Application of IFRS 17 and IFRS 9 – Comparative Information (not adopted into the FREM, this will apply from 2025 onwards for NHS entities)				○				
Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2)			●		✓			
Definition of Accounting Estimate (Amendments to IAS 8)			●		✓			
Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction (Amendments to IAS 12 Income Taxes)				○	✓			
Initial Application of IFRS 17 and IFRS 9 – Comparative Information (Amendments to IFRS 17) (issued on 9 December 2021)			●		✓			
International Tax Reform—Pillar Two Model Rules (Amendments to IAS 12)				○	✓			
Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)				○		✓		✓
Classification of liabilities as Current or Non-Current and Non-current Liabilities with Covenants (Amendments to IAS 1 Presentation of Financial Statements)				○		✓		✓
Supplier Finance Arrangements (Amendments to IAS 7 and IFRS 7)				○		✓		✓
Lack of exchangeability (Amendments to IAS 21)				○			✓	✓
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures) *				○				✓
UK legislation on international tax system reform (BEPS)				○		✓		

Appendix ten

Audit quality, evidence & the timeline of completion activities

Audit quality is at the core of everything we do – the quality and timeliness of information received from management and those charged with governance also affects audit quality.

The timeline on this page is for illustration only and shows the timing of our completion activities around the signing of the audit opinion. We depend on well planned timing of our audit work to avoid compromising the quality of the audit. We aim to complete all audit work no later than 2 days before audit signing.

Weeks before signing Audit Opinion	-3 weeks	-2 weeks			-1 week		Completion week			Teams involved in the process
Individual day's activities		Day 1	Day 3	Day 5	Day 1	Day 5	Day 1	Day 3	Day 5	
Audit report Reviews, Consultation	■									Audit Team
Final audit fieldwork	■	■	■	■	■	■				Audit Team
Review audit field work & provide points to the audit team		■	■	■	■	■				2nd Line of Defence
Review significant risk audit areas and challenge work performed		■	■	■	■	■				RI and EQCR
Review of the Audit Report		■♦	■	■						DPP Accounting & Reporting
Ensure points raised by Audit Report review are dealt with		■	■	■						RI and EQCR
Review Audit Committee report and draft accounts		■	■	■						RI and EQCR
Completion panel to discuss the draft Audit Committee report and draft accounts			♦				♦			Audit Risk Review Panels
KPMG Audit Committee report issued				♦						Audit Team
Final Audit Committee						♦				Audit Team
Ensure Audit Report review and Consultation points have been satisfactorily dealt with							♦			Audit Team & DPP Accounting & Reporting
Final audit field work completed and signed off							■	■♦		Audit Team
Stand-Back review								♦		Audit Team
Ensure all points raised are cleared								♦		RI / EQCR / 2nd Line of Defence

Key:
♦ One day activity
■ Activity over a period of time
Year end
Signing date of the Audit Report

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