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Planning report



Director introduction

The key messages in this report:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

We have pleasure in presenting our draft planning report to the Audit Committee for the year ending 31 March 2018 audit. We would like to draw your attention to the key messages of this draft audit plan:

Audit Plan

We have updated our understanding of the Board including discussion with management and review of relevant documentation from across the Board as well as Audit Scotland performance audit reports published during the year.

Based on these procedures, we have developed this plan in collaboration with the Board to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the Board.

Key Risks

We have taken an initial view as to the significant audit risks the Board faces. These are presented as a summary dashboard on page 15.

- NHS Shetland continues to face significant financial challenges. The Board approved the financial plan for 2017/18 based on efficiency savings of £4.7m to be made in the year, £2.2m of this is carried forward from 2016/17.
- For the period to 30 September 2017, total savings of £1.7m have been reported to Scottish Government, £0.8k of this is recurring. £296k is still outstanding against the planned trajectory.
- NHS Shetland has reported an overspend of £1.2m for the period to 30 September 2017, primarily due to overspend caused by GP locums and unachieved efficiency savings. The Board has recognised that significant management action is required to be taken to ensure that it can achieve financial balance at the year end. The achievement of a breakeven position will be a key focus of our audit.
- Our significant audit risk around achievement of expenditure resources is pinpointed to accruals and prepayments made at the year-end.
- In accordance with auditing standards, management override of controls has also been identified as a significant audit risk.
- Having considered the risk factors set out in Auditing Standards and the nature of the revenue streams at NHS Shetland, we have determined that the risk of fraud arising from revenue recognition can be rebutted. This is based on the fact that there is little incentive to manipulate revenue with the majority of income coming from Scottish Government which can be agreed to confirmations supplied.

Director introduction (continued)

The key messages in this report (continued):

Audit Dimensions

- The 2016 Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how NHS Shetland is addressing these and report our conclusions in our annual report to the Audit Committee in June 2018. In particular, our work will focus on:
 - **Financial sustainability** – We will review the work of the Transformational Change Board and how this is driving the Boards plans to achieve long term financial sustainability. We will also review how the Board is developing its workforce plans in light of service redesign. There is currently a risk around how benefits are realised from service redesign projects and also how this impacts on achieving financial targets.
 - **Financial management** – we will review the budget and monitoring reports to the Board during the year and liaise with internal audit in relation to their work on the financial control environment to assess whether financial management and budget setting is effective. From our audit work in 2016/17 we found that the Board had acceptable financial management procedures in place however, there remains a risk that a lack of appropriate financial management could result in the Board not achieving its financial targets.
 - **Governance and transparency** – from our review of Board papers and attendance at Audit Committees we will assess the effectiveness of governance arrangements including the arrangements for securing effective clinical governance and engagement and audit committee attendance. We will also review the governance arrangements in relation to the Integrated Joint Board (IJB). As the IJB is still relatively new and has significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the NHS Board and the IJB (and the partner Council) are not effective.
 - **Value for money** – From our 2016/17 audit work we concluded that the Board had a well established performance management framework in place, with performance regularly considered by management, and the Board. During 2017/18 we will review how the Board is addressing areas where targets are not being met and also how the implementation of the Strategic Change Programme is impacting on how the Board's performance is measured and reported. There is a risk that insufficient resources are targeted to areas of under performance.

Director introduction (continued)

The key messages in this report (continued):

Other wider scope work

We will continue to monitor the Boards participation and progress with the National Fraud Initiative (NFI) during 2017/18 and complete an Audit Scotland audit questionnaire by 28 February 2018.

In accordance with Audit Scotland guidance, we will be requested to provide information to support national performance audits on Digital and Health and Social Care Integration.

Regulatory Change

There are limited changes this year affecting the audit, though the Scottish Government Health and Social Care Directorates (SGHSCD) has not yet issued the annual accounts manual and capital accounting manual for 2017/18.

We would highlight that new accounting standards on financial instruments will apply from 2018/19, and for leases from 2019/20 and it is important that the Board considers their impact ahead of implementation. See pages 27-28 for more details.

Our Commitment to Quality

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

Adding value

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.

Pat Kenny
Audit director

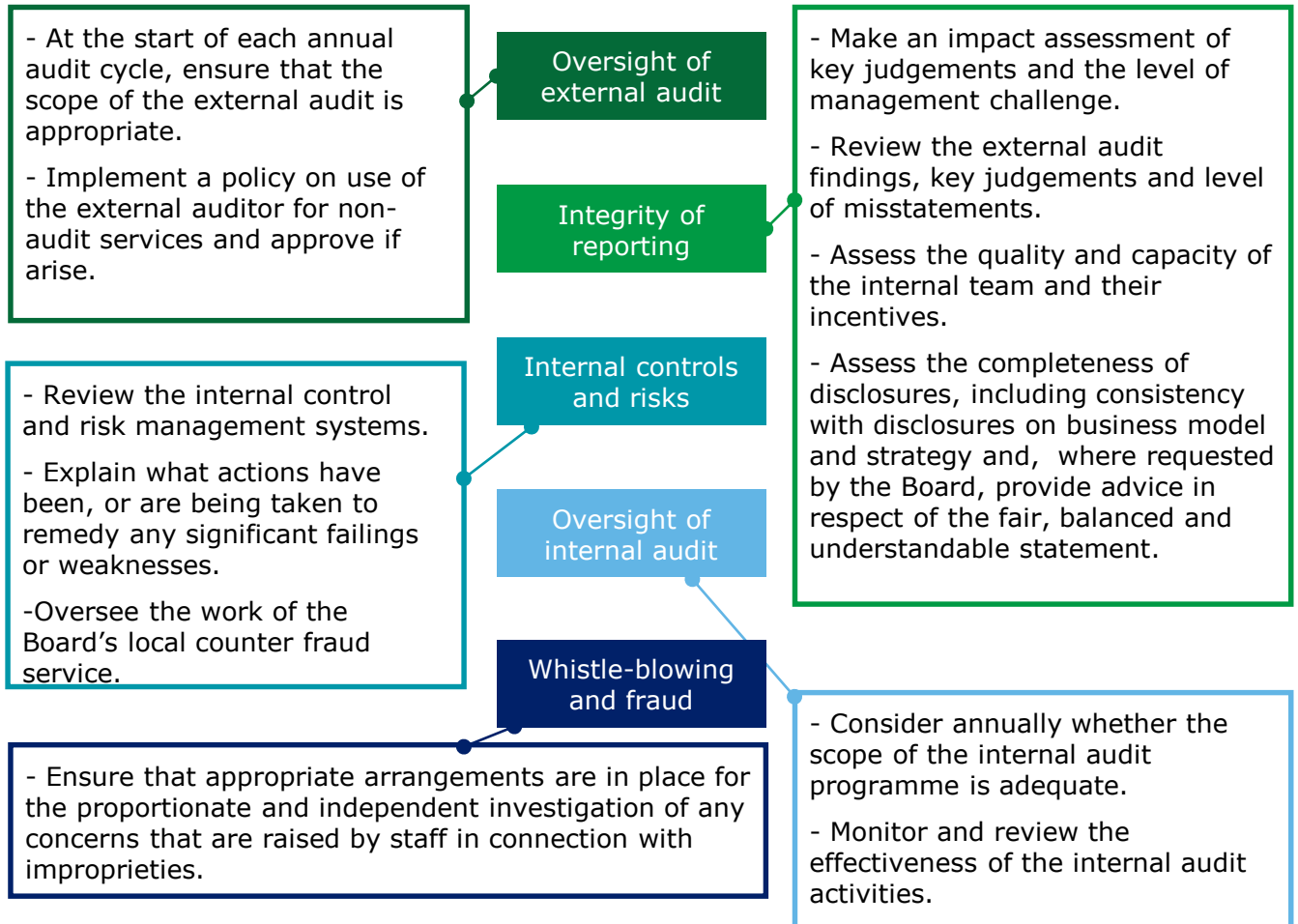
Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Audit Committee:

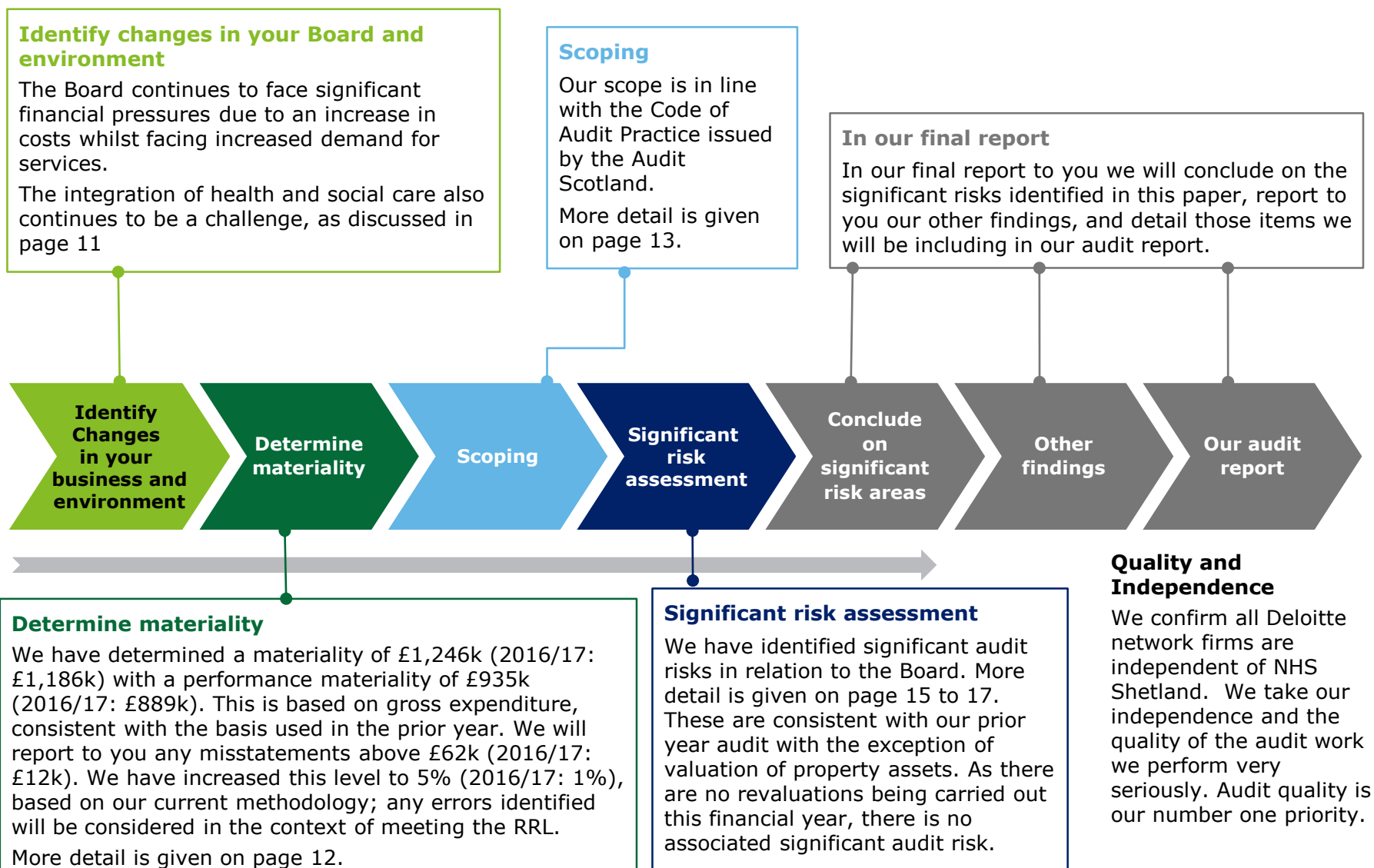
- Clearly communicate the planned scope of the financial statements audit
- Provide timely observations arising from the audit that are significant and relevant to the Audit Committee's responsibility to oversee the financial reporting process
- In addition, we seek to provide the Audit Committee with additional information to help fulfil your broader responsibilities

As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.



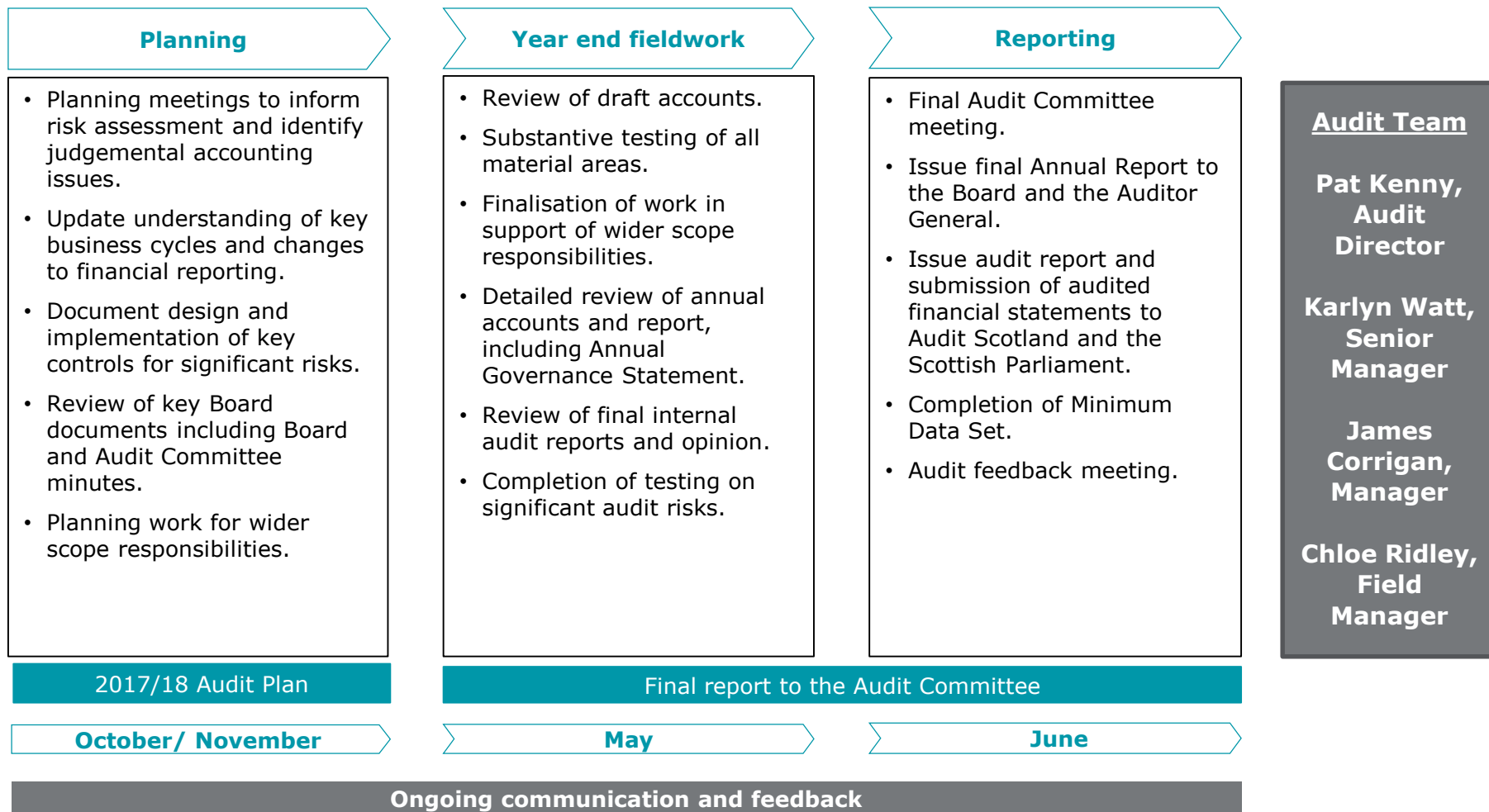
Our audit explained

We tailor our audit to your Board and your strategy



Continuous communication and reporting

Planned timing of the audit



An audit tailored to you

Focusing on your business and strategy

Impact on our audit

Performance against expenditure resource limit



There is a financial duty for NHS Shetland to comply with its Revenue Resource Limit (RRL), Capital Resource Limit (CRL) and cash requirements. As at September 2017, the Board is reporting an overspend of £1.2m against Core Revenue Resource Limit and therefore there is a risk that the targets are not met, impacting on our opinion on regularity. NHS Shetland have projected that they will breakeven for 2017/18. We will evaluate the results of our audit testing in the context of the achievement of these targets. Our significant audit risk has been pinpointed to accruals and prepayments at the year end as these areas have a higher risk of management override as discussed further on page 16.

The Board must continue to look at how it can reduce costs to meet the challenge of making significant savings each year. As raised in our 2016/17 audit report, it is critical for NHS Shetland to identify and implement recurring saving opportunities to reduce its savings deficit and become a more cost effective organisation. We will therefore review the work of the Transformational Change Board (TCB) and how this is driving the Boards plans to achieve long term financial sustainability.

Service redesign



NHS Shetland is faced with particular challenges associated with the sustainability of services and recruitment and retention of its workforce, who work in small or single handed teams. For a number of years, NHS Shetland has had to make efficiency improvements over and above the national 3% target to allow the Board to get back into recurrent balance, provide investment to sustain local services and to address ongoing pressures such as short term locums, associated with delivering services in a remote and rural setting.

We will review the work done around efficiency and redesign projects, including the governance arrangements in place around delivery and benefits realisation through the work of the TCB. As raised in our 2016/17 audit report it is crucial that the TCB is supported by robust benefits realisation processes with a change management strategy to help the Board in achieving its recurring savings target.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

An audit tailored to you

Focusing on your business and strategy

Impact on our audit

Health and Social Care Integration



2016/17 saw the first full financial year of Health and Social Care Integration between NHS Shetland and the Shetland Islands Council through the Integration Joint Board (IJB). As reported in our 2016/17 annual audit report to the IJB, the biggest risk facing the IJB was the projected overspend in 2017/18 and the efficiencies required over the next three years to achieve a balanced budget. It is critical that the NHS Board work closely with the IJB and Shetland Islands Council to focus on implementing recurring savings through efficiencies or service redesign.

We will continue to review the work being done both at the NHS Board and the IJB to address these funding gaps.

NHS in Scotland 2017



Audit Scotland published its annual overview report on the NHS in Scotland in October 2017. This highlighted a number of key themes and recommendations which are consistent with the issues noted above specific to NHS Shetland around capital investment strategies, workforce planning, monitoring of savings and working with the public, local communities and staff. We have included the key messages from this report on page 22 and will consider how the Board have addressed these as part of our work referred to above.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

Materiality

Our approach to materiality

Basis of our materiality benchmark

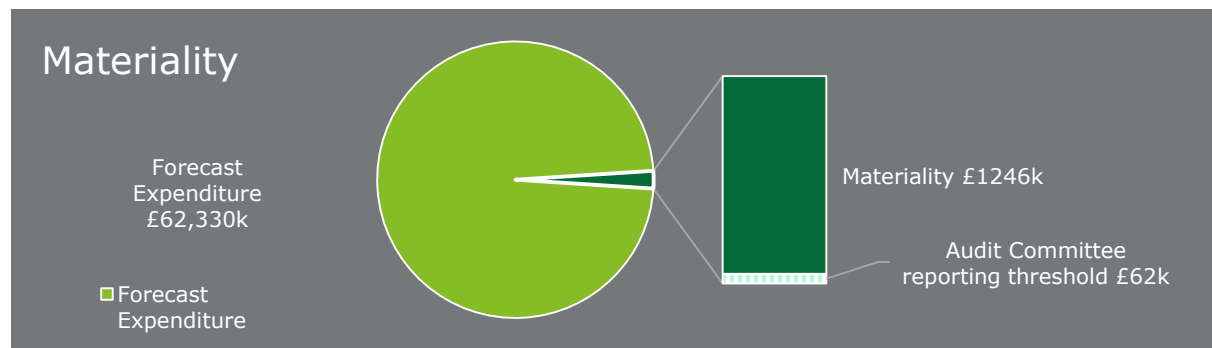
- The audit director has determined materiality as £1,246k (2016/17: £1,186k) and a performance materiality of £935k (2016/17: £889k), based on professional judgement and risk factors specific to NHS Shetland, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of forecasted gross expenditure as the benchmark for determining materiality.
- This approach is consistent with our prior year materiality calculation.
- We will report to you misstatements below this threshold if we consider them to be material by nature.
- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £62k (2016/17: £12k).
- We have increased this level to 5% (2016/17: 1%) of materiality based on our current methodology; any errors identified will be considered in the context of meeting the RRL.
- Report the materiality benchmark applied in the audit of the Board;
- provide comparative data and explain any changes in materiality, compared to prior year, if appropriate; and
- explain any normalised or adjusted benchmarks we use, if appropriate.

Our annual audit report

We will:



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.



Scope of work and approach

Our key areas of responsibility under the Code of Audit Practice

Core audit

Our core audit work as defined by Audit Scotland comprises:

- Providing the **Independent Auditor's Report** on the annual accounts (and any assurance statement on consolidation packs);
- providing the **annual report** on the audit addressed to the Board and the Auditor General for Scotland;
- communicating **audit plans** to those charged with governance;
- providing **reports to management**, as appropriate, in respect of the auditor's corporate governance responsibilities in the Code (including auditors' involvement in the NFI exercise);
- preparing and submitting **fraud returns**, including nil returns, to Audit Scotland where appropriate;
- identifying significant matters arising from the audit, alert the Auditor General for Scotland and support Audit Scotland in producing statutory reports as required; and
- undertaking work requested by Audit Scotland or local performance audit work.

Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability** – looking 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.
- **Financial management** – financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency** – the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money** – using resources effectively and continually improving services.

Scope of work and approach (continued)

Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Board's staff.

Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D&I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We have also designed and continually update International Financial Reporting Standards ("IFRS") disclosure checklists in conjunction with the requirements of the FReM to support the Board in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the Board complete during drafting.

We will continue to review an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management and the audit committee.

Audit Scotland has published good practice guides in relation the Annual Report and the Governance Statement to support the Board in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the Board consider during drafting.

Obtain an understanding of the Board and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

Significant risks Dashboard



Risk	Material	Fraud risk	Planned approach to controls testing	Level of management judgement	Page no.
Achievement of expenditure resource limits			Design and implementation		16
Management override of controls			Design and implementation		17



Some degree of management judgement



Limited management judgement

Significant risks (continued)

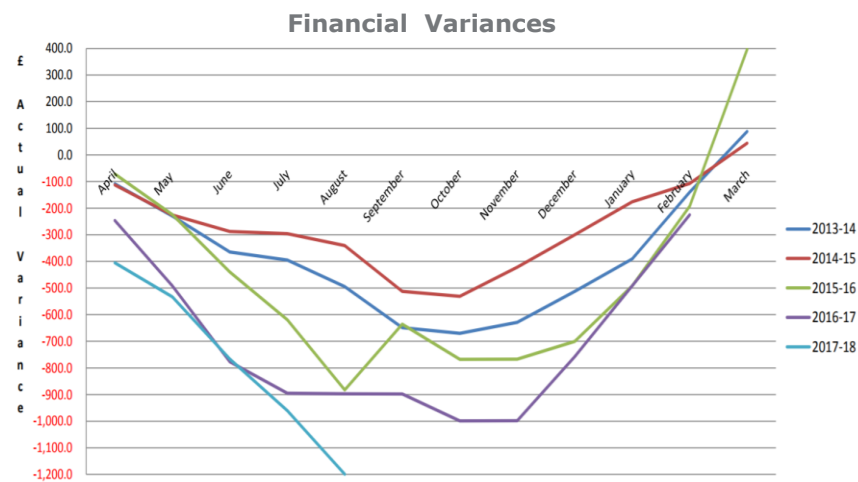
Risk 1 – Achievement of expenditure resource limits

Key focus for management

Risk identified

There is a key financial duty for NHS Shetland is to comply with the Revenue Resource Limit set by the Scottish Government.

The risk is that the Board could materially misstate expenditure in relation to year end transactions, in an attempt to align with its tolerance target or achieve a breakeven position. The significant risk is therefore pinpointed to accruals and prepayments made by management at the year end and invoices processed around the year end as this is the area where there is scope to manipulate the final results. Given the financial pressures across the whole of the public sector, there is an inherent fraud risk associated with the recording of accruals and prepayments around year end.



Our response

We will evaluate the results of our audit testing in the context of the achievement of the target set by the Scottish Government.

Our work in this area will include the following:

- obtain independent confirmation of the resource limits allocated to NHS Shetland by the Scottish Government;
- Perform focused testing of accruals and prepayments made at the year end; and
- performing focused cut-off testing of invoices received and paid around the year end.

Deloitte Comment

The Board underspent by £312k against its RRL in 2016/17, This maintained the Board's financial policy of spending its annual allocation and managing within the flexibility of around 1% on brought-forward and carry-forward surpluses.

As at 30 September 2017, NHS Shetland is forecasting to meet its financial resource limits at year end.

Significant risks (continued)

Risk 2 – Management override of controls

We will use computer assisted audit techniques, including Spotlight, to support our work on the risk of management override

Risk identified

In accordance with ISA 240 (UK and Ireland) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Board's controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risk around expenditure recognition. This is inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Planned audit challenge

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

- We will test journals, using our Spotlight data analytics tool, to focus our testing on higher risk journals;
- We will review accounting estimates for bias that could result in material misstatements due to fraud;
- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

Deloitte Comment

We have not identified in our prior year audit work any transactions which appear unusual or outside the normal course of business. We have completed our testing on the design and implementation of controls around management override of controls and note no issues.

Wider scope requirements

Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how NHS Shetland in addressing these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2017/18 Audit
<p>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.</p>	<ul style="list-style-type: none"> • The financial planning systems in place across the shorter and longer terms • The arrangements to address any identified funding gaps • The affordability and effectiveness of funding and investment decisions made • Workforce planning 	<p>From our work in 2016/17, we recommended that NHS Shetland implements recurring savings. We will review the work of the TCB and how this is driving the Boards plans to achieve long term financial sustainability.</p> <p>Audit Risk: There is a risk that the plans for efficiency and service redesign are not robust to allow the benefits to be realised.</p> <p>We will review how the Board is developing its workforce plans in light of service redesign.</p> <p>Audit Risk: A continued reliance on locum doctors and temporary staff could impact on the Board achieving its financial targets.</p>
<p>Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively</p>	<ul style="list-style-type: none"> • Systems of internal control • Budgetary control system • Financial capacity and skills • Arrangements for the prevention and detection of fraud 	<p>We will review the budget and monitoring reporting to the Board during the year to assess whether financial management and budget setting is effective. From our audit work in 2016/17 we found that the Board had sound financial management procedures in place.</p> <p>Our fraud responsibilities and representations are detailed on pages 32 and 33.</p> <p>Audit Risk: A lack of appropriate financial management could result in the Board not achieving its financial targets.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2017/18 Audit
<p>Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> • governance arrangements • Scrutiny, challenge and transparency on decision making and financial and performance reports • Quality and timeliness of financial and performance reporting 	<p>We will review the financial and performance reporting to the Board during the year as well as minutes of all Board meetings to assess the effectiveness of the governance arrangements. Our attendance at Audit Committees will also inform our work in this area. We will consider the arrangements in place for securing effective clinical governance and engagement. Our audit work in 2016/17 found no issues.</p> <p>We will also review the governance arrangements in relation to the IJB.</p> <p>Audit Risk: As the IJB is still relatively new and has significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the NHS Board and the IJB (and the partner Council) are not effective.</p>
<p>Value for money is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> • Value for money in the use of resources • Link between money spent and outputs and the outcomes delivered • Improvement of outcomes • Focus on and pace of improvement. 	<p>From our 2016/17 audit work we concluded that the Board had a well established performance management framework in place, with performance regularly considered by management, and the Board.</p> <p>During 2017/18 we will review how the Board is addressing areas where targets are not being met and also how the implementation of the Strategic Change Programme is impacting on how the Board's performance is measured and reported.</p> <p>Audit Risk: there is a risk that insufficient resources are targeted to areas of under performance.</p>

Wider scope requirements (continued)

Specific risks

As part of the 2017/18 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. While we have not identified any specific risks in relation to these areas for NHS Shetland, we will continue to monitor these areas as part of our audit work.

Risk	
EU withdrawal	<p>There remains significant uncertainty about the detailed implications of EU withdrawal. Nonetheless, given the potential timetables involved, it is critical public sector bodies are working to understand, assess and prepare for the impact on their business. Key aspects of this are likely to include three broad areas:</p> <ul style="list-style-type: none">- Workforce- Funding- Regulation
New Financial Powers	<p>The provisions of the 2012 and 2016 Scotland Acts and the accompanying Fiscal Framework agreement are leading to fundamental changes to the Scottish public finances. New tax raising, borrowing and social security powers provide the Scottish Parliament with more policy choice, but also mean the Scottish budget is subject to greater volatility, uncertainty and complexity. There is also a stronger link between the performance of the Scottish economy (relative to the rest of the UK) and available funding.</p> <p>The changes are likely to impact across public sector bodies to varying degrees, both directly (for example where an organisation's activities include additional responsibilities as a result of the new powers) and indirectly (for example as a result of potential changes to the way the Scottish Government manages its overall budget).</p>

Wider scope requirements (continued)

Specific risks (continued)

Risk	
Ending of public sector pay cap	<p>Pay increases in the public sector have been frozen and then capped at 1% for seven years. Politicians in both Westminster and Holyrood are talking about ending the public sector pay cap.</p> <p>When introducing the Programme for Government 2017-18, the First Minister confirmed that the Scottish Government will lift the 1% public sector pay cap. It remains unclear which public sector workers will benefit from lifting the cap, when the increases will take effect, and how such increases will be funded.</p> <p>All public bodies need to consider the potential impact of the ending the pay cap as they prepare their budgets and consider their financial sustainability.</p>
Response to cyber security risks	<p>Audit Scotland will issue further guidance in relation to this risk, setting out the risk context for public bodies, the new cyber resilience requirements being introduced by the Scottish Government and questions that auditors can pose to bodies to understand the risk and mitigating action in a local context. We will share this with management when this is available.</p>
Openness and transparency	<p>There are signals of changing and more challenging expectations for openness and transparency in public business. In view of this direction of travel, Audit Scotland noted that 2016/17 annual audit reports highlighted the need for public bodies to keep this area under review and to consider whether there is scope to enhance transparency.</p>

Wider scope requirements (continued)

NHS in Scotland 2017

Audit Scotland published its annual overview report **NHS in Scotland 2017** in October 2017. It concluded that significant activity is under way to transform Scotland's healthcare system, but a number of crucial building blocks still need to be put in place. The report made a number of recommendations specific to NHS Boards, shown below. We will evaluate NHS Shetland against these considerations as part of our wider scope work.

To provide the foundation for delivery of the 2020 Vision and changing the way healthcare services are provided:

The Scottish Government, in partnership with NHS boards and integration authorities should:

- develop a capital investment strategy to ensure the NHS Scotland estate is appropriate for delivering more regional and community-based services.
- Continue to develop a comprehensive approach to workforce planning.

To improve governance, accountability and transparency:

The Scottish Government and NHS boards should:

- work together to develop a consistent way of measuring and reporting savings to ensure that it is clear how boards have planned and made savings, and what type of savings they have made.

To promote the culture change necessary to move to new ways of providing and accessing healthcare services:

The Scottish Government, NHS boards and integration authorities, should:

- continue to work with the public, local communities and staff to develop a shared understanding and agreement on ways to provide and access services differently.
- Work together to embed the principles of 'realistic medicine' in the way they work, monitor progress in reducing waste, harm and unwarranted variation; and creating a personalised approach to care.

Wider scope requirements (continued)

NFI, Performance audits and impact reports

National Fraud Initiative (NFI)

All health boards, except for the Mental Welfare Commission, are participating in the NFI 2016/17. All data was submitted in October 2016 and boards received matches for investigation in January 2017. Audit Scotland expects bodies to investigate all recommended matches based on findings and the risk of error or fraud. Match investigation work should be largely completed by 30 September 2017 and the results recorded on the NFI system.

In accordance with Audit Scotland planning guidance, we are required to monitor the Board's participation and progress during 2016/17 and 2017/18 and complete an NFI audit questionnaire by 28 February 2018. The information contained in this questionnaire will be used for Audit Scotland's NFI report to be published in June 2018. When our 2016/17 audit report was presented investigation results were still to be posted in the NFI system and a review of matches had not yet been completed, however plans were in place to complete.

Performance Audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits on the following subjects during the year:

Performance audit title	Appointed auditor input
Digital – cross cutting	No formal return. Audit Scotland will provide information and guidance on current issues and risks to consider as part of planning process.
Health and social care integration part 2 – publication Autumn 2018	There is a requirement for a minimum data set in support of this audit. Specific requirements will be confirmed, however, it will encompass information such as: timescales for agreeing budgets; shifts in resources from acute to community-based care; progress in agreeing budgets and publishing meaningful strategic plans; governance arrangements

Impact reports

We will be requested to provide information to support Audit Scotland's Performance Audit and Best Value (PABV) team in assessing the impact of the following performance audits during 2017/18: Changing models of health and social care; Social work in Scotland; and Supporting Scotland's economic growth.

Audit Quality

Our commitment to audit quality



Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

We will apply professional scepticism on material issues and significant judgements identified, by using our expertise in the health sector and elsewhere to provide robust challenge to management.

We have obtained a deep understanding of your business, its environment and of your processes in expenditure recognition, payroll expenditure and capital expenditure enabling us to develop a risk-focused approach tailored to NHS Shetland.

Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve specialists to support the audit team in our work.

In order to deliver a quality audit to you, each member of the core audit team has received tailored learning to develop their expertise in audit skills, delivered by Pat Kenny, Audit Director. This is a director led programme encouraging teams from across our practice to engage and discuss current sector and audit issues, sharing best practice and expertise. This is in addition to a practice wide health training day held prior to the end of the financial year to share key issues from across the country, to update on regulatory changes and provide early warning of issues other teams may have faced at the interim testing phase.



Engagement Quality Control Review

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Board.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

We will update you if there are any significant changes to the audit plan.

This report has been prepared for the Audit Committee, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.



Pat Kenny, CPFA

for and on behalf of Deloitte LLP

Glasgow

21 November 2017

Technical update

Information on sector developments



IFRS 9 *Financial Instruments*

In a nutshell

- In July 2014, the IASB published a final version of IFRS 9. This version supersedes all previous versions.
- IFRS 9 *Financial Instruments* will replace IAS 39 *Financial Instruments: Recognition and Measurement*, and has three main impacts
 - *Classification and measurement* - introduces new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. This classification determines how financial assets are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.
 - *Amortised cost and impairment of financial assets* - introduces an “expected losses” impairment model where entities are required to account for expected credit losses from when financial instruments are first recognised.
 - *Hedge accounting* - introduces new general hedge accounting model that aligns the accounting treatment with risk management activities and allows for better reflection of the hedging activities in the financial statements.
- HM Treasury proposes to apply IFRS 9 from 2018/19 onward, with a number of interpretations and adaptations for the public sector, generally simplifying the requirements. Although the 2018/19 HM Treasury Financial Reporting Manual (“FRm”) has not been published, HM Treasury papers set out the proposed approach.
- The key practical change in IFRS 9 for most NHS bodies is the introduction of a new approach to recognising impairments of debtors and other financial instruments.
- HM Treasury’s proposed adaptations are principally to simplify the accounting for balances with core central government departments (but not most Arm’s Length Bodies).

Potential impact on the Board

IFRS 9 is expected to have relatively limited impact on most NHS Boards, but will at least affect the process of assessing impairment of debtors and other financial assets. As part of the process of adoption, the Board will need to consider the impact on policies, processes, systems and people.

Effective date

The Standard has a mandatory effective date for annual periods beginning on or after 1 January 2018, with earlier application permitted.

HM Treasury proposes to apply IFRS 9 from 2018/19 onward.

HM Treasury is proposing that on transition there will be no restatement of comparatives, and any impact of transition will be recognised as a reserves movement in 2018/19.



Find out more on our
website UK Accounting
Plus by clicking [here](#)
Navigate to: Standards/
IFRS 9

IFRS 16 Leases

In a nutshell

- The new Standard supersedes IAS 17 *Leases* and its associated interpretative guidance.
- For lessees the distinction between operating and finance leases disappears.
- A lease conveys the right to control an identified asset for a period of time in exchange for consideration.
- The accounting for all leases is similar to finance lease accounting in IAS 17, which means all leases are recognised on the balance sheet (with some exceptions).
- The lease liability is measured at the present value of the future lease payments, using a lease term that includes periods covered by extension options if exercise is reasonably certain. Variable lease payments are only included in the liability if based on an index or rate.
- That right-of-use asset is initially measured at the amount of the lease liability, plus initial direct costs and adjustments for lease incentives, payments at or prior to commencement and dilapidations provisions.
- The right-of-use asset is subsequently accounted for by applying IAS 16 *Property, Plant and Equipment*, at cost less depreciation and impairment (unless it is an investment property that is fair valued or it belongs to a class of property, plant and equipment that is revalued).
- A lessee can elect to keep the following leases off-balance sheet and typically straight line the expense:
 - leases with a lease term of 12 months or less and containing no purchase option – this election is made by class of underlying asset; and
 - leases where the underlying asset has a low value when new, such as personal computers or small office furniture – this election is made on a lease-by-lease basis.
- Operating lease expenses, typically straight line, will be replaced with interest on the liability and depreciation of the asset, producing a front-loaded expense profile but boosting metrics such as EBITDA.
- Although any individual lease will have a front-loaded expense, portfolios of leases containing both new and mature leases may produce an overall expense profile similar to straight line expensing.
- HM Treasury has consulted across government and is considering specific interpretations and adaptations for consistency across the public sector, but which will follow the overall principles of IFRS 16.

Potential impact on the Board

The Board has relatively low operating lease commitments (with commitments at 31 March 2017 of £269k), mitigating the effect of the change and will have a relatively small impact.

Effective date

Periods commencing on or after 1 January 2019. HMT is planning to adopt for 2019/20 in the public sector.



Find out more on our website UK Accounting Plus by following the links to Standards -> IFRS 16

General Data Protection Regulation

The EU GDPR will come into effect from 25 May 2018, and will effectively supercede the existing Data Protection Act.

Issue

The EU General Data Protection Regulation (“GDPR”) will come into effect in 2018, replacing the Directive that formed the basis for the Data Protection Act. The GDPR is expected to remain in effect for the foreseeable future, notwithstanding Brexit.

The key new concept is of “accountability” – being able to **demonstrate** compliance, with specific actions required with an evidence trail.

- Data Protection Impact Assessments are required for high risk processing of data, and there are specific requirements for transparency and fair processing of data. There are tighter rules where consent is the basis for processing data.
- There are requirements to keep records of data processing activities, with the removal of most charges for providing copies of records to patients or staff who request them.
- Penalties for breaches of the regulation are significantly higher than existing arrangements (up to €10m for data breaches and up to €20m for breaches of the principles), and apply to any breach of the regulation, not just data breaches.
- All public authorities, including NHS bodies, are required to appoint a suitably qualified and experienced Data Protection Officer.
- There is a legal requirement to notify security breaches to the Information Commissioner within 72 hours.

Getting ready to comply with the GDPR can start with reducing the risk of the data breaches – and reducing that risk doesn’t need to be complicated. The biggest causes of data breaches can be avoided by making sure the basics are in place: keep all operating systems and software up to date, implement encryption for sensitive data, and educate all employees about the risk of phishing and other social engineering attacks.

Your organisation might also consider the [Cyber Essentials scheme](#) and the [10 Steps to Cyber Security](#), both developed by Government to ensure any organisation can protect themselves from common cyber-attacks.

The Information Commissioner’s Office has also developed a useful [12 step guide](#) to help organisations consider their current data protection activities and what needs to be done to comply with the new regulations. They will be developing guidance over the coming months so keep an eye on [their website](#) for more information.

Deloitte View

Privacy as a concept is broad and far-reaching. The GDPR impacts many areas of an organisation, and is not just a legal/compliance issue. The GDPR brings specific rights to the public, including the “right to be forgotten” and data portability.

The emphasis on organisational accountability will require proactive, robust privacy governance. A key challenge is the need to identify a suitably qualified Data Protection Officer, with an estimated need for 28,000 DPOs across Europe.

The requirements will change how information technologies are designed and managed, with a requirement for documented privacy risk assessments when implementing major new systems, with “Privacy by Design” now enshrined in law.

The requirement to notify security breaches within 72 hours will require new or enhanced incident response procedures.

Teams tasked with information management will need to provide clearer oversight on data storage, journeys and lineage. Greater clarity on what data is collected and where it is stored will make it easier to comply with the new data subject rights.

Next steps

The Audit Committee should consider how it is obtaining assurance over the adequacy of the Board’s action plans to ensure compliance with the GDPR.

Appendices



Prior year audit adjustments

Uncorrected and disclosure misstatements

Uncorrected misstatements

There were no uncorrected misstatements identified during the course of our prior year audit.

Disclosure misstatements

There were no uncorrected disclosure misstatements identified during the course of our prior year audit.

Fraud responsibilities and representations

Responsibilities explained



Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.



Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of fraud in the achievement of expenditure resource limits and management override of controls as a key audit risk for your organisation.



Fraud Characteristics:

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Board:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud that affects the entity or group and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.



Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:



Management:

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

Internal audit and Local Counter Fraud Specialist

- Whether internal audit and the Board's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.



Those charged with governance

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.



Independence and fees



As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Board and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2018 in our final report to the Audit Committee.

Fees

Fee range for the 2017/18 audit to be provided by Audit Scotland in early December 2017 will be discussed and agreed with management and the Audit Committee in early 2018.

Details of any non-audit fees for the period will be presented in our final report.

Non-audit services

We continue to review our independence and ensure that appropriate safeguards are in place in relation to any non-audit services provided including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

Relationships

We have no other relationships with the Board, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Our approach to quality

AQR team report and findings



We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2017 the Financial Reporting Council ("FRC") issued individual reports on each of the six largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2016/17 cycle of reviews.

The review performed by the AQR forms an important part of our overall inspection process. We perform causal factor analysis on each significant finding arising from both our own internal quality review and those of our regulators to identify the underlying cause. This provides insight which drives the developments in our quality agenda.

18 of the audits reviewed by the AQR were performed to a good standard with limited improvements required. We were disappointed that, despite the high standards we set and many areas of improvement in our quality record, the percentage of audits rated as requiring more than limited improvements has remained broadly similar to the previous year and that two reviews were identified as requiring significant improvement.

We have taken swift and decisive action to respond to the matters identified and will continue to monitor the implementation of these. We are firmly committed to achieving, and indeed exceeding, the FRC's objective that by 2019 90% of FTSE 350 audits reviewed will be assessed as requiring no more than limited improvements.

All the AQR public reports are available on its website.

The AQR's 2016/17 Audit Quality Inspection Report on Deloitte LLP

"We reviewed selected aspects of 23 individual audits in 2016/17. In selecting which aspects of an audit to inspect, we took account of those areas identified to be of higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements. The communications with the Audit Committee and the audit of revenue were reviewed on nearly all of these audits..."

"The firm has taken the actions they committed to take following our last inspection. Some of the issues driving more adverse quality assessments this year are in similar areas to those reported last year, although some audits reviewed were undertaken before these actions had been carried out. Our main concern continues to be the adequacy of audit teams' challenge of management in key areas of judgment (particularly goodwill impairment) and further immediate action is required to improve audit quality in this area.

The firm has enhanced its policies and procedures in the following areas:

- Strengthened the evidence of the Engagement Quality Control Review ("EQCR") partner and audit technical reviewer involvement.
- Updated Deloitte's audit methodology to include additional focus on risk assessment and the related audit response (effective from 31 December 2016 year-end audits).
- Introduced more focused coaching for audit teams throughout the audit process.
- Issued more timely and focused guidance and reminders to the audit practice on key audit matters, to facilitate appropriate consideration by audit teams at the key stages of the audit.
- Increased mandatory technical training for qualified staff through to partner level

Our key findings in the current year requiring action by the firm, which are elaborated further in section 2 together with the firm's actions to address them, are that the firm should:

- Improve the extent of challenge of management in key areas of judgment, in particular impairment reviews and valuation of acquired intangible assets.
- Strengthen the firm's audit of revenue recognition.
- Make further improvements to the audit of defined benefit pension scheme balances in corporate entities.
- Continue to seek to improve the consistency of the quality of communications with Audit Committees."

Our approach to quality

Areas identified for particular attention	How we have addressed these as a firm	How addressed in our audit
Strengthen the firm's audit of revenue recognition.	<p>A key theme of the enhancements to our methodology in 2016, (deployed after these engagements reviewed by the AQR were complete), was to enhance our risk assessment procedures and, as a result, encourage our auditors to develop more robust responses to the largest most critical account balances, with a natural focus on revenue.</p> <p>This included the removal of capped sample sizes for very large balances and facilitation of a combination of test of details and substantive analytical procedures to enable more comprehensive audit responses to be designed.</p> <p>This theme has continued in 2017 when our Summer Technical Training showcased our investment in analytic tools applied to the audit of revenue, as well as training on the accounting and auditing of revenue as we prepare to audit the implementation of the new revenue standard IFRS 15 'Revenue from Contracts with Customers' which is effective for periods beginning on or after 1 January 2018.</p>	<p>We have determined that the risk of fraud arising from revenue recognition can be rebutted for NHS Shetland.</p> <p>This is based on the fact that there is little incentive to manipulate revenue recognition with the majority of revenue being from the Scottish Government which can be agreed to confirmations supplied.</p> <p>There is a risk however that NHS Shetland materially misstates expenditure in relation to year end transactions, in an attempt to align with its tolerance target or achieve a breakeven position.</p> <p>This is a significant audit risk and is addressed in page 16 of this paper.</p>
Continue to seek to improve the consistency of the quality of communications with Audit Committees.	<p>We take our responsibilities for reporting to the Audit Committee very seriously. There is a natural follow on that if there is a failure in the underlying audit work we will inevitably fall short in our reporting on those areas. The majority of issues noted in the report linked directly to the review findings.</p> <p>We continue to stress the critical importance of reporting matters to the Audit Committee in the training we deliver and in the enhanced procedures we have established, in particular around key management estimates and judgments. We have issued refreshed Audit Committee reporting templates to the practice reflecting the observations of the reviews to ensure audit practitioners continue to focus on this critical aspect of our role.</p>	<p>We have reported to you in page 13 and 14 of this paper the Scope of work and the planned approach to the audit.</p> <p>We would welcome any feedback on our approach to communicating with you.</p>



Our approach to quality

Areas identified for particular attention	How we have addressed these as a firm	How addressed in our audit
<p>Improve the extent of challenge of management in key areas of judgment, in particular impairment reviews and valuation of acquired intangible assets.</p>	<p>We have developed an Impairment Centre of Excellence and have mandated its involvement in all public interest entity audits with a material goodwill or intangibles balance for years ending on or after 15 December 2016. The specialists within the Impairment Centre of Excellence, in addition to having significant experience auditing complex impairment issues, have had specialist training to be able to identify and respond to the issues raised in the AQR report.</p> <p>Our Summer Technical Training in 2017 included interactive workshops on this area including sharing anonymised findings from internal and external review to illustrate the types of challenge and extent of audit evidence that teams should seek to achieve in this area.</p>	<p>The Board does not have a goodwill balance or a material intangible asset balance, and so this is not applicable for the Board's audit.</p>
<p>Make further improvements to the audit of defined benefit pension scheme balances in corporate entities.</p>	<p>We have improved our procedures to ensure confirmations are obtained from asset custodians where appropriate. In December 2015 we introduced a detailed practice aid dedicated to all areas of corporate pension balance auditing together with increased training.</p> <p>We have also mandated consultation with our Pension Audit Centre of Excellence for years ending on or after 15 December 2016 and refreshed the practice aid. This ensures our corporate audit teams have access to our experts in the audit of pension balances.</p>	<p>The Board does not have an on-balance sheet defined benefit pension scheme, and so this is not applicable for the Board's audit.</p>





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