

Final report to the Board and the Auditor General for Scotland on the 2015/16 audit



9 June 2016

the
Distinctive
audit

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A reminder of our audit plan:

- **Materiality: £3,928k (2014/15: £4,370k).** This is slightly higher than communicated within our planning report due to the finalisation of expenditure limits at year end.
- **Performance materiality: £3,535k (2014/15: 3,933k).**
- **Threshold for reporting misstatements: £39k (2014/15: £39k).**
- **Significant risks over compliance with core expenditure resource limits, revenue recognition, accounting for the office rationalisation and associated provisions and management override of controls**
- **We have taken a fully substantive approach to audit, with no controls reliance.**
- **We have not identified any additional significant risk areas since our plan was issued.**
- **There have been no changes to our audit plan presented to you in January 2016.**



Partner introduction

Partner introduction

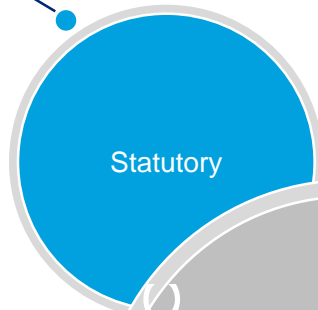
Overview of responsibilities

I have pleasure in presenting our final report to the Board for the 2015/16 audit.

As set out in our plan presented to the Audit Committee in January 2016, we have early adopted the requirements of the new Code of Audit Practice which comes into force for the 2016/17 audits. A reminder of the requirements is set out below.

Financial Statements

Provide an opinion on the financial statements and the regularity of transactions.



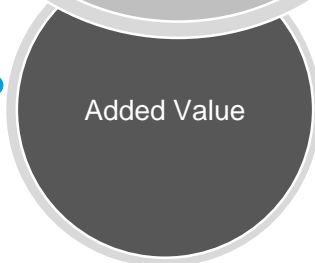
Annual Reports

Review and report on the other information such as annual governance statement, management commentaries, remuneration reports.



Public reporting

Audit plans, the principal audit outputs arising from audit plans and any other outputs on matters of public interest will be published on Audit Scotland's website.



Public Sector audit dimensions

Wider scope reporting covering financial sustainability, financial management, governance & transparency and value for money

Audit quality is our number one priority. When planning our audit we 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.

Partner introduction (continued)

Financial statement audit and annual report

Financial statement audit

Conclusions from our testing

- The key judgements in the audit process related to:
 - The office rationalisation programme and the associated dilapidations provision; and
 - Achievement of expenditure resource limits.
- We have not identified any misstatements or disclosure deficiencies from audit work performed.
- Based on the current status of our audit work, we envisage issuing an unmodified audit opinion.

Status of the audit

- The audit is substantially complete subject to the completion of the following principal matters:
 - Receipt of final version of the financial statements;
 - Receipt of consolidation template;
 - Completion of Minimum Data Set;
 - Finalisation of quality control procedures;
 - Receipt of signed management representation letter; and
 - Our review of events since 31 March 2016.

Annual report

Overall conclusion

- We have reviewed the annual report with reference to the new disclosure requirements for 2015/16 accounts.
- The annual report now contains a Performance Report and an Accountability Report in accordance with the FReM. Management have ensured that the new reports meet the requirements, consolidating their previous remuneration reporting, directors' report and governance statement sections.
- We have read the performance report and concluded that it is consistent with the financial statements. We have also read all other information in the annual report and accounts, including the governance statement and noted no inconsistencies with our knowledge acquired during the audit.
- We are satisfied that disclosures are appropriate and in line with requirements, with no disclosure deficiencies noted.

Partner introduction (continued)

Significant financial statements risk dashboard



Fraud risk	Controls approach and findings	Consistency of judgements with Deloitte expectations	Comment
Core expenditure resource limits			
✘	Evaluate design / implementation of key controls. No controls reliance. No significant observations.	●	We have confirmed that NES has performed within the limits set by the Scottish Government. We have assessed the split of capital and revenue expenditure and completed testing to ensure that there were no unrecorded liabilities at year end. No issues were noted.
Office Rationalisation: Dilapidations Provision			
✘	Evaluate design / implementation of key controls. No controls reliance. No significant observations.	⊖	Leases have been agreed to legal documentation and rent-free period has been recalculated with no issues noted. The dilapidations provision has been assessed and is considered to be on the prudent end of the reasonable range given the Board's historic experience of negotiating significantly reduced dilapidation settlements.
Management override of controls			
✔	Evaluate design / implementation of key controls. No controls reliance. No significant observations	●	We have noted no issues with journal entries and other adjustments made in the preparation of the financial statements.
Income recognition: completeness of funding			
✔	Evaluate design / implementation of key controls. No controls reliance. No significant observations.	●	Income recognised agrees to the final allocation per the Scottish Government and is recognised appropriately.

Overly prudent, likely to lead to future credit



Overly optimistic, likely to lead to future debit.

Partner introduction (continued)

Public sector audit dimensions

We have commented below on the public sector audit dimensions with regard to NHS Education for Scotland ('NES').

Financial management

The final outturn was a overspend against the core revenue resource limit of £26k, as well as an underspend of £429k against the non core revenue resource limit. There was a £10k saving made against the core capital resource limit. Further, there was an £8k overspend in relation to the cash requirement.

The financial management framework and budgetary control systems are well controlled and expenditure is linked to the Board's strategic objectives.

Financial sustainability

Financial sustainability continues to be the single most significant challenge and risk for NHS Education. The 2016/17 budget and the three-year Financial Plan were agreed by the Board on 10 March 2016. The budget details the savings schemes identified to meet the anticipated funding gap of £5.3m.

There is also as an unidentified target of £800k of efficiency savings required to fully balance the budget. It is also noted that further savings will be required in future years.

In accordance with Audit Scotland planning guidance, we have performed targeted follow up work on the recommendations made in the national performance report on *Scotland's Public Sector Workforce* which was published in November 2013. We concluded that significant resources are brought to bear on workforce planning arrangements within NES and it is clear that this is an iterative process. NES continues to respond to areas of weakness highlighted through audit reports, such as the lack of succession planning, and to address these weaknesses moving forward.

Governance and transparency

Governance arrangements are effective within NES with committees of the Board overseeing governance and performance monitoring.

We have reviewed the financial and performance reporting to the Board during the year. Monthly management reports are clear and produced in a timely manner.

In a review of arrangements in relation to governance, Internal Audit found that NES has robust and effective processes in place to ensure project monitoring and reporting activity is consistent and of appropriate quality, and that monitoring and reporting activities follow a risk-based methodology and are linked to corporate objectives.

Value for money

We have performed testing over both core and non-core expenditure and noted no issues.

Further, we concluded that the Board had a well established performance management framework during 2015/16. This was supported by effective performance monitoring.

Scope, nature and extent of audit

Scope, nature and extent of audit

Our overall responsibility as external auditor of the Board is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

The special accountabilities that attach to the conduct of public business, and the use of public money, means that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements and associated documents such as governance statements, but providing a view also, where appropriate, on matters such as regularity (or legality), propriety, performance and use of resources in accordance with the principles of Best Value and 'value for money'.

Our core audit work as defined by Audit Scotland comprises:

- Providing the Independent Auditor's Report on the financial statements (and any assurance statement on consolidation packs);
- Providing the annual report on the audit 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 National Fraud Initiative (NFI) exercise);
- Identifying significant matters arising from the audit, alert Audit Scotland accordingly and supporting Audit Scotland in producing statutory reports as required; and
- Undertaking work requested by Audit Scotland or local performance audit work.

In addition to this annual report, we have completed and reported the following matters to those charged with governance (the Audit Committee) of the Board:

- Planning Report; and
- Progress reported to each Audit Committee meeting.

The key issues from these outputs are summarised in this report.

The Board is responsible for preparing annual accounts that show a true and fair view and for implementing appropriate internal control systems. The weaknesses or risks identified are only those that have come to our attention during our normal audit work, and may not be all that exist. Communication in this report of matters arising from the audit of the annual accounts or risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.



Significant risks

Core Expenditure Resource Limits

Key focus for management

Nature of risk

Key financial duty for NES to comply with the Revenue Resource Limit, Capital Resource Limit and cash requirements set by the Scottish Government. Given the financial pressures faced by the Board, there is a risk that these limits are exceeded.

Key judgements

We must provide an opinion on regularity, to the effect that expenditure and receipts were incurred or applied in line with guidance. We have evaluated the results of our audit testing in the context of the achievement of the targets set by the Scottish Government and have noted no issues.

	Expenditure £000s	Resource Limit £000s	Excess (Saving) £000s
Core Expenditure	431,207	431,181	26
Non core expenditure	1,165	1,546	(429)
Capital Resource Limit	702	712	(10)
Cash Requirement	428,374	428,366	(8)

Deloitte response

Audit work performed to address the significant risk

- We assessed whether expenditure is correctly classified between revenue and capital and whether it has been incurred in accordance with Scottish Government's guidance;
- We also obtained independent confirmation of the resource limits allocated to NES by the Scottish Government in its letter of 4 May 2016 and we have agreed the cash draw down to the bank statements.

Deloitte view

- We have concluded through the performance of our year end procedures, the expenditure and receipts were incurred or applied in accordance with the applicable enactments and guidance issued by the Scottish Ministers and the expenditure is valid and correctly classified between revenue and capital.
- We confirm that whilst NES exceeded its Core Expenditure target by £26k, underspends against other targets mean that overall it has performed within the limits set by the Scottish Government Health and Social Care Directorate (SGHSCD).

Revenue recognition

Completeness of funding

Risk Identified

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

The risk is pinpointed to completeness of funding given the significance to the organisation.

Key judgements

As funding is notified and agreed with the Scottish Government, there are limited areas of judgement in revenue recognition within NES.

Deloitte response

We have reviewed the treatment of income to assess whether it is in line with the financial reporting manual (FReM).

We have agreed the funding recognised by NES to the year-end funding statement obtained from the Scottish Government. As noted on slide 11, we have agreed the monthly draw downs to the bank statements.

No issues noted from our review of the treatment of income in the year, which has been accounted for in line with the FReM.

Deloitte view

- We have concluded through the performance of our year end procedures that funding recorded is complete at year end.
- We do not consider there to be evidence of management bias in the revenue recognition policies adopted.

Office Rationalisation Project

Dilapidations Provision

Nature of the risk

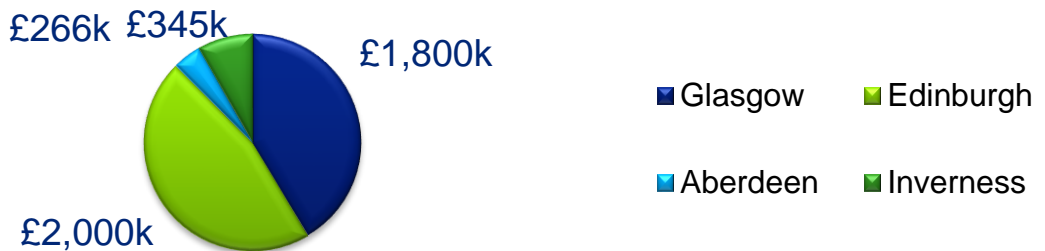
The office rationalisation project is ongoing, with discussions commencing around the potential move and reduction of space in Aberdeen. There are two key ongoing risks identified around this project:

- 1) Completeness of dilapidations provision; and
- 2) Accuracy of any onerous lease calculation.

Key judgements

The key judgement is in relation to the dilapidation provision itself. There is limited judgement around the accounting treatment of leases given the defined accounting standards that apply.

The total dilapidation provision at year end is £4,022k (PY: £4,066k) which is made up as follows:



Deloitte response

- We have recalculated the movement in the year, which is a result of the provisions being held at net present value.
- We are satisfied that there were no onerous leases at year end.
- We have also reviewed lease agreements and recalculated the lease incentives included within the lease agreement being the rent free period and the landlord contributions to assess that they have been spread across the life of the lease, with no issues noted.
- As in the prior year, Deloitte noted that based on the fact that historically pay-outs have been significantly lower than that provided for, the provisions are on the more prudent end of the acceptable range.



Deloitte view

From our audit procedures, we are satisfied that the provision is not materially misstated.

Management override of controls

We have used computer assisted audit techniques to support our work on the risk of management override

Risk Identified

ISA 240 requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or fraudulent financial reporting.

Key judgements

Our audit work is designed to test for instances of management override of controls. We have summarised above our work on key estimates around revenue recognition and provisions with no issues identified.

Deloitte response

- No issues were noted around journal entries and other adjustments made in the preparation of the financial statements.
- Our review of accounting estimates for bias that could result in material misstatement due to fraud noted no issues.
- Our retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements was completed with no issues noted.
- We have made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments. We have used analytics tools to test a sample of journals, based upon identification of items of potential audit interest. Our analysis covered all manual journals posted in the year. Investigation of items sampled did not identify indicators of management override.
- We did not identify any significant transactions outside the normal course of business or transactions where the business rationale was not clear.

Deloitte view

We have not identified any significant bias in the key judgements made by management or instances of management override of controls.

Public sector audit dimensions

Financial management

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

Revenue expenditure

NES budgeted a breakeven position for the year to 31 March 2016. In December 2015, it forecast an year end underspend position of £481k, in January 2016 this had reduced to a forecast underspend of £410k. The final outturn was a surplus against the non-core revenue resource outturn of £429k, offset by excess core expenditure of £26k.

The table below illustrates how the Board's performance compares to prior year, and budget for 2015/16, and forecast for 2016/17.

	2014/15 Total £'000	2015/16 Budget £'000	2015/16 Total £'000	2016/17 Forecast £'000
Income	434,399	420,305	432,775	430,393
Expenditure	(433,657)	(420,305)	(432,272)	(430,393)
Surplus	642	-	403	-

During 2015/16, NES has consistently underspent on staff costs as a result of ongoing staff vacancies and vacancies in GP training grades. These underspends have been partially offset by overspends in capital charges and provisions, which have arisen through a number of factors, such as a lower than anticipated underspend in this areas carried forward from the previous year and the movement in the provisions required for the cost of terminating Fixed Terms Contracts.

Budget management was reviewed by Internal Audit during 2014/15 and at this time 4 out of 5 control areas reviewed were found to be satisfactory, with no major weaknesses found in the remaining area. In 2014/15, arrangements in relation to payroll and expenses were reviewed by Internal Audit, with similar findings, that there were no major weakness identified.

As part of targeted follow up work completed as part of last year's audit, we reviewed the financial capacity in NES and concluded that activities and planned outcomes are linked to the Strategic Plan for the year ahead, and are costed and recorded on the board's IPPS system, which is used to ensure that Directorates deliver a balanced budget. Good practice was also identified where Directorates are also able to bid against any unallocated monies by providing information and costings for proposed activities and outcomes and how they link to the strategic plan.

Deloitte Conclusion

The budget monitoring undertaken during the year was completed with a significant degree of accuracy, with the forecast position as at December 2015 only differing from the outturn position by £78K, less than 1% of revenue expenditure.

Expenditure is effectively controlled and monitored, and activities and outcomes are linked to the Strategic Plan.

Financial sustainability

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.

Financial outlook

Financial stability continues to be the single most significant challenge and risk for NES. In 2016/17, they have identified a cost pressure in relation to salaries of £9.3m arising from an anticipated 1% cost of living award and the removal of the employer's National Insurance contribution rebate in relation to contracted out pension schemes. This required saving is partially offset by an anticipated increase in income of £4m. However, there remains a requirement to identify substantial in-year savings. In identifying the measures required to achieve a balanced budget for 2016-17, a strong focus is required to be placed on the primary objective of NES, which is to support the education, training and workforce development of those who work in and with NHS Scotland.

The 2016/17 budget and the three-year Financial Plan were agreed by the Board on 10 March 2016. The budget details the savings schemes identified to meet the anticipated funding gap. Schemes include decreasing the amount of space used in the Aberdeen office when a lease break occurs in 2017, use of voluntary severance schemes, efficiency reviews across all directorates, introduction of a recruitment lag across all vacancies and active pursuit of income generation opportunities.

There is also an unidentified target of £800k of efficiency savings required to fully balance the budget. It is also noted that further savings will be required in future years.

NES has committed to continuing to review all areas of its activity to identify where further recurrent savings can be made and will focus on maximising the outcomes of its Digital Strategy to reduce its own digital administration costs and to drive savings across NHS Boards through roll out of the NES Digital Platform (now known as the Turas platform), which includes a trainee management application and a learning and management of learning application.

Deloitte Conclusion

As with all NHS Boards, NES has challenging savings targets to meet moving forward to continue to be financially sustainable. Historically NES has successfully achieved their savings targets and they have made good progress in identifying schemes to achieve these savings in 2016/17. These schemes appear to be realistic and robust. Aiming to build upon the success of their Digital Platform to increase income rather than reduce spending is a good example of an entrepreneurial approach.

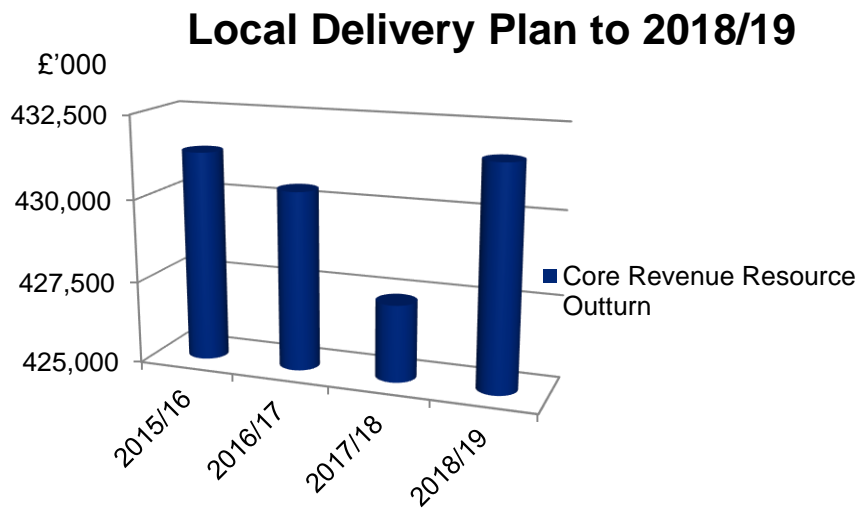
We would, however, highlight that there is a risk that the £800k of unidentified efficiency savings required in 2016/17 may not be achieved.

Financial sustainability (continued)

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.

Delivery

We have reviewed the Local Delivery Plan for 2016/17, 2017/18 and 2018/19, and have noted no issues in terms of the key assumptions used by management.



Workforce Planning

Throughout 2015/16, NES has continued to implement a significant programme of organisational change. NES has driven forward with the change agenda implemented by the Scottish Government, including the workforce development requirements.

In accordance with Audit Scotland planning guidance, we have performed targeted follow up work on the recommendations made in the national performance report on *Scotland's Public Sector Workforce* which was published in November 2013.

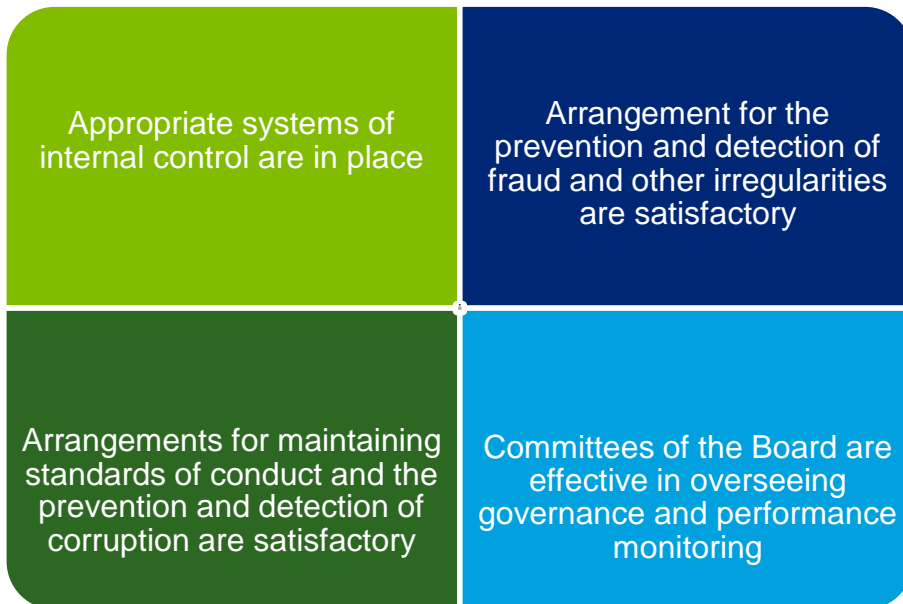
Deloitte Conclusion

We concluded that significant resources are brought to bear on workforce planning arrangements within NES and it is clear that this is an iterative process. NES continues to respond to areas of weakness highlighted through audit reports, such as the lack of succession planning, and to address these weaknesses moving forward.

Governance and transparency

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

In accordance with the Code of Audit Practice, we are required to consider and formally report in relation to the following key matters:



There have been several changes in the Board during 2015/16, including the appointment of a new Chief Executive in October 2015 and the previously Acting Director of Finance being formally appointed in February 2016. There were no issues arising as a result of these transitions, as both are individuals with long service in NES and both had already been in post in an acting capacity.

Deloitte Conclusion

We confirm that we have reviewed the arrangements in each of the four areas and have identified no issues in this regard.

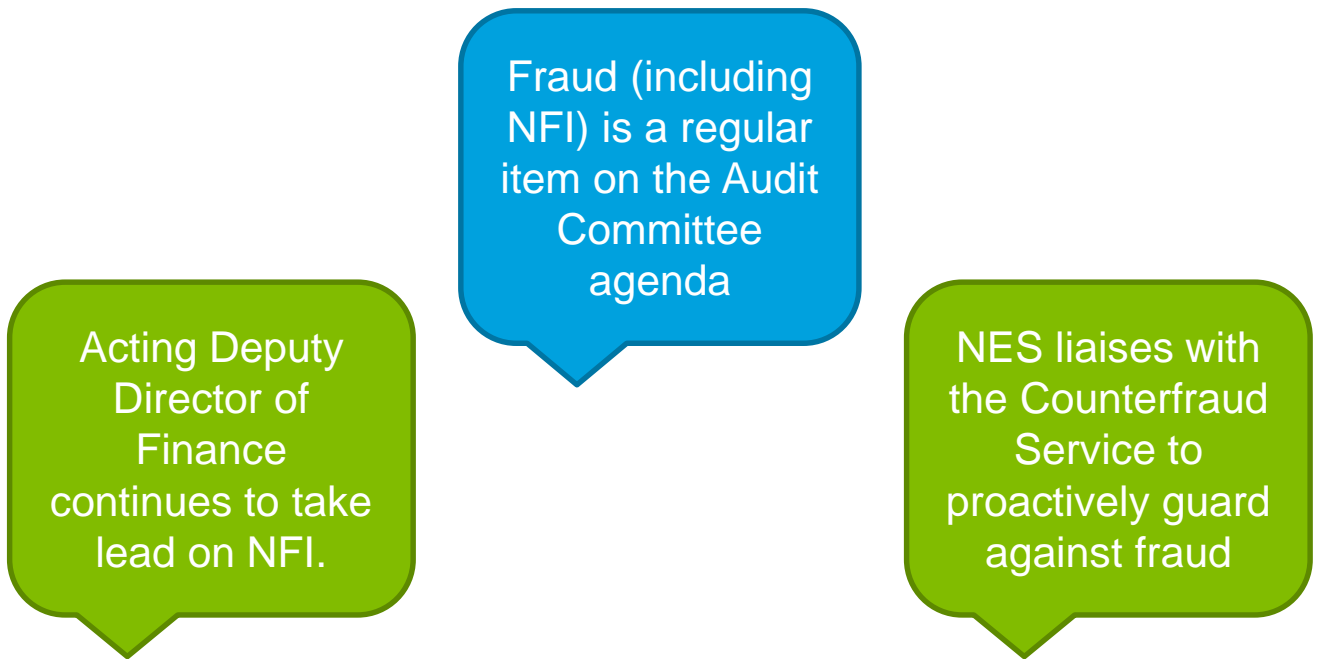
We have no concerns around the arrangements with Internal Audit. We placed no direct reliance on the work of the internal auditors.

NES take a pro-active approach to tackling fraud and in 2015/16 they worked together with Internal Audit to undertake a gap analysis to ensure that appropriate fraud prevention arrangements were in place. We are comfortable with the fraud arrangements in place and confirm there have been no financially significant frauds of which management have made us aware.

Governance and transparency (continued)

National Fraud Initiative

In accordance with Audit Scotland planning guidance, we are required to monitor the Board's participation and progress during 2015/16 and completed an NFI audit questionnaire by 29 February 2016.



Deloitte Conclusion

We reported in our 2014/15 annual report, that resources were being allocated within NES to address all recommended matches within the period June to December 2015. At the time the NFI questionnaire was completed in February 2016, the results of investigations had been recorded in the NFI system and all recommended matches had passed through an initial review. By the end of March 2016, all investigations had been completed and all cases had been closed, with the exception of one immigration status case, where matters are in hand.

No cases of fraud were identified through this exercise, however one over-recovery of VAT of £841 was identified. This over-recovery was claimed in error, has since been repaid and processes have been amended to prevent this occurring again.

Value for money

Value for money is concerned with using resources effectively and continually improving services.

Performance management

The performance of NES is monitored by the Scottish Government against a number of HEAT targets and standards which support the delivery of the Scottish Government's national performance framework. These targets and their trajectories were set out in the Board's 2015/16 Local Delivery Plan (LDP).

Performance against HEAT targets and standards is presented to the Board. These performance reports also include progress against local performance indicators. The overall approach adopted is that performance management is integral to the delivery of quality and effective management, governance and accountability. The need for transparent and explicit links to performance management and reporting within the organisational structure at all levels is critical. There is a comprehensive framework of measures at directorate and service level and the targets are linked to the Board's 5 strategic themes:

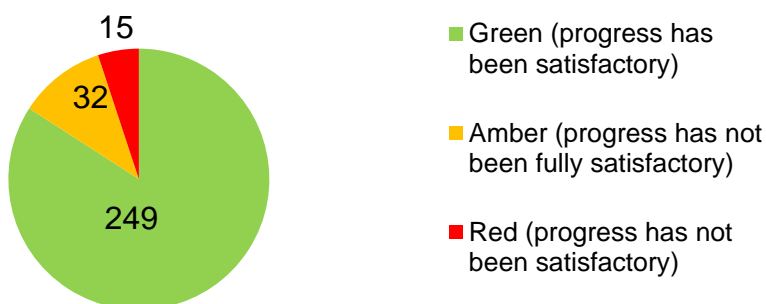
- An Excellent Workforce
- Quality Improvement
- New Models of Care
- Enhanced Educational Infrastructure
- An Improved Organisation

We concluded that the Board had a well-established performance management framework during 2015/16. This was supported by effective performance monitoring.

Overview of performance targets in 2015/16

The most up to date data available, which was reported to the May Performance Board, is summarised below:

Performance against HEAT Targets 2015/16



Areas where progress has not been satisfactory have generally been linked to recruitment and the Finance Transformation Project, where a number of targets have been delayed. There is recognition that the Board's priority in the year has been delivering externally facing outcomes and that all outcomes must be achieved moving forward.

Deloitte Conclusion

We are satisfied that the board has made significant progress against 2015/16 HEAT Targets, performance is accurately discussed within the Performance Report in the Annual Accounts and management have plans to address areas where progress has not been satisfactory.

Value for money (continued)

Audit Scotland national reports

The following reports have been issued by Audit Scotland over the past year which may be of interest to Board members:

Title	Headline messages	Impact on NES
NHS in Scotland 2015 <i>Published October 2015</i>	Fundamental changes and new ways of delivering healthcare are required now to ensure the NHS is able to continue providing high-quality services in the future.	With appropriate support from the Scottish Government, NES's long term planning should be assessing its spending needs and options over a longer period of 5-10 years. It should also ensure that its work to meeting financial and performance targets also support longer-term changes to delivering healthcare. This will help ensure that short term actions do not conflict with longer term plans.
Health and Social Care Integration <i>Published December 2015</i>	Significant risks must be addressed if a major reform of health and social care is to fundamentally change how services are delivered, and improve outcomes for the people who use them.	While not directly impacting on NES, Integrated Joint Boards need to set out clearly the resources, such as funding and skills, that they need. NES has a key role to play in providing the education, training and workforce developments for staff across Scotland.
Changing models of health and social care <i>Published March 2016</i>	A lack of national leadership and clear planning is preventing the wider change urgently needed if Scotland's health and social care services are to adapt to increasing pressures.	
Reshaping care for older people – impact report <i>Published March 2016</i>	This report looks at the impact made by the report <i>Reshaping care for older people</i> , which was published in February 2014.	

We note that there is a standard item on each Audit Committee agenda for sharing all relevant Audit Scotland reports and are subsequently passed to Chief Officers and Executive Team for consideration of required action and further dissemination as appropriate.

During 2015/16 the following reports were considered by the Audit Committee –

- Financial Capacity in Public Bodies
- NHS Overview 2014/15
- Health and Social Care Integration: Position Statement
- Changing Models of Health and Social Care : Scope and Timetable
- NHS in Scotland 2015
- Health and Social Care Integration.

Your annual report

Our comments on your annual report

We welcome this opportunity to set out for the Audit Committee our observations on the annual report. We are required to read the “front half” of your annual report to consider consistency with the financial statements and any apparent misstatements. Here we summarise our observations on your response to these areas:

The Performance Report

Management response

The report outlines NES’s performance, both financial and non-financial, focussing on strategic priorities. It outlines the strategic objectives, performance monitoring arrangements and key priorities, as required.

Deloitte response

Deloitte has ensured that the disclosures meet the minimum requirements of the FReM.

The Accountability Report – overall observations

Management response

Management have ensured that the accountability report meets the new requirements, consolidating their previous remuneration reporting, directors’ report and governance statement sections.

Deloitte response

Deloitte has ensured that the disclosures meet the requirements of the FReM and the Governance Statement adopts the good practice set out in the recent Audit Scotland Good Practice Note.

Remuneration policy and reporting requirements

Management response

Management has made appropriate disclosure within the Remuneration and Staff Report, including noting the policy regarding senior management pay and also disclosing off payroll engagements (nil in both current and prior year).

Deloitte response

Deloitte have challenged management’s assumptions and judgements and have audited each disclosure in the accounts. We have concluded both treatment and disclosure are appropriate.

Going concern

Management response

Management has made appropriate disclosure relating to Going Concern matters. The balance sheet shows a net liabilities position, given the requirement for NES to show liabilities without showing anticipated funding from the SGHSCD.

Deloitte response

Deloitte have challenged the assumptions built into the local delivery plan and have concluded that the plan is sufficiently robust to demonstrate that NES will be a Going Concern for 12 months from signing the accounts.

Purpose of our report and responsibility statement

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 help the Audit Committee and the Board discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK and Ireland) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Other insights we have identified from our audit.

What we don't report

- As you will be aware, our audit was 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, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

The scope of our work

- Our observations are developed in the context of our audit of the financial statements.
- We described the scope of our work in our audit plan and the supplementary "briefing on audit matters" previously circulated to you.

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

Deloitte LLP

Chartered Accountants

Edinburgh

9 June 2016

Appendices



Audit adjustments



No misstatements noted

Uncorrected misstatements

There have been no known uncorrected misstatements noted during the process of our audit work.

Corrected misstatements

There have been no corrected misstatements noted during the process of our audit work.

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable audit committees to evaluate the impact of those matters on the financial statements. We have noted no material disclosure deficiencies to date in the course of our audit work.

Action Plan

Our recommendations for improvement

We present a summary of observations on the Board's internal control and risk management processes

Observation:

We recommend that NES ensures all journals are reviewed prior to posting. From our journal entry testing performed we have noted that there were manual journals from February and March which had not been marked as reviewed by the Head of Financial Services prior to posting. Whilst no issues were noted from our testing, it is recommended that sufficient time is allocated to the journal review process as part of the financial statement closing procedures, so as to ensure the control is operating as intended.

Management Response:

From discussion with management, this was due to time constraints around year end, as a result of staffing changes. The client noted that they were looking to move towards a faster system of journal entries, with the journals being prepared, signed off and authorised online, which would significantly reduce the time before authorisation.

Responsible Person:

Timescale:

Fraud responsibilities and representations

Responsibilities explained



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. 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.

Required representations

We have asked the Board to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity.

We have also asked the Board to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

Audit work performed

- In our planning we identified the risk of fraud in other income recognition and management override of controls as a key audit risk for the Board.
- During course of our audit, we have had discussions with management and those charged with governance.
- In addition, we have reviewed management's own documented procedures regarding the fraud and error in the financial statements. No issues have been identified from our work performed.

Concerns

- As set out above we have identified the risk of fraud in other revenue recognition and management override of controls as a key audit risk for your organisation.

Independence and fees

There are no issues we wish to raise to you



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

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	Our audit fee for the year from 1 April 2015 to 31 March 2016 is £68,500 (inclusive of VAT and Audit Scotland fixed charges) and is within the indicative fee range set by Audit Scotland. There were no non-audit services for the period.
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the Board's policy for the supply of non-audit services or of any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place 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 are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence. We are not aware of any relationships which are required to be disclosed.

Events and publications

Our events and publications to support the Board

Sharing our informed perspective

We believe we have a duty to share our perspectives and insights with our stakeholders and other interested parties including policymakers, business leaders, regulators and investors. These are informed through our daily engagement with companies large and small, across all industries and in the private and public sectors.

Recent publications relevant to the NHS are shared below:

Perspectives: Health & Social Care - The great integration challenge

Bringing health and social care closer together has been a policy ambition for decades, yet it continues to be a challenge. This new piece discusses some of the key factors that affect integration and what can realistically be achieved. Read the full blog post here:

<http://www2.deloitte.com/uk/en/pages/public-sector/articles/the-great-integration-challenge.html>

Perspectives: The public sector's talent retention challenge – How can a talent drain be avoided?

Although global governments are increasingly conscious of the value of skills, the UK's public sector workforce has been hit hard by austerity. Job losses, low morale and pay freezes have all fuelled concerns of a potential drain. Read the full blog here:

<http://www2.deloitte.com/uk/en/pages/public-sector/articles/public-sectors-talent-retention-challenge.html>

Publications

Decoding Digital Leadership

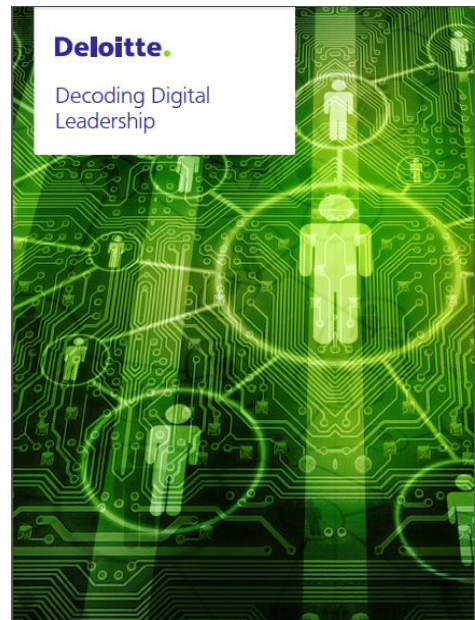
Surviving Digital Transformation

Digital transformation is a hot topic in government. The 2010 Spending Review mentioned the word 'digital' only four times in its reform plans, while the 2015 Review mentioned it 58 times. With that context, are senior leaders across government setting their organisations up for digital success?

Digital transformation requires top to bottom organisational transformation, which requires leaders who are willing and able to leverage digital to innovate, fail fast and drive value in an ambiguous context. Are your leaders equipped to drive digital transformation?

Download a copy of our publication here:

<http://www2.deloitte.com/uk/en/pages/public-sector/articles/decoding-digital-leadership.html>



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