

NHS Highland

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

2016/17 Financial Year

27 June 2017



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Our audit plan at a glance:

Materiality has increased to £10.7million (from £8.4million) following receipt of the unaudited annual report ad accounts which include the Argyll and Bute Integrated Joint Board figures for the first time.

Performance materiality has increased in line with materiality and was set at £6.9million. We have reported to management everything identified over £107,000 (1% of materiality).

Financial statement risks were: management override of controls; risk of fraud in revenue recognition; consolidation of Argyll & Bute IJB; completeness of operating expenses; valuation of Local Government Pension Fund liability ;and property plant and equipment valuations.

We also identified wider scope risks in relation to: future financial sustainability, including achievement of 2016/17 targets; and governance arrangements especially around joint working with the IJB.

We can confirm we are independent of NHS Highland and our objectivity is not compromised in accordance with International standards on Auditing (UK & Ireland) and APB ethical standards for Auditors.

No non-audit services have been provided to NHS Highland in 2016/17. Our audit fee was £172,990 (£135,250 external audit remuneration). This has not changed since our plan and our plan contains the fee breakdown.

Key Messages

We have issued an unqualified opinion on:

- True and fair view of the financial statements
- Regularity
- Other prescribed matters

Under International Standards on Auditing (ISAs) we are required we are required to report to those charged with governance the main issues arising from our audit of the annual report and accounts.

This report discharges our obligations under the relevant ISAs and is a summary of the findings from our external audit work for the financial year ended 31 March 2017. Our work has been undertaken in accordance with International Standards on Auditing (UK & Ireland) and the Code of Audit Practice (2016).

Our report is addressed to the Board (in their role as those charged with governance) and the Auditor General for Scotland. This report will be published on the Audit Scotland website at: www.audit-scotland.gov.uk

This report has been discussed and agreed with management, and presented to the Audit Committee and then the Board on 27 June 2017. We would like to thank management and staff for their co-operation and assistance throughout our audit work.

Our work included:

- An audit of the 2016/17 annual report and accounts.
- A review of the Performance Report and Accountability Report (including governance statement and remuneration report).
- Completion of the 'Role of Boards' return submitted to Audit Scotland to inform a future performance publication.
- The annual NHS Minimum dataset return.
- Completion of the National Fraud Initiative (NFI) return and review of data matching progress.

We received a good complete draft annual report and accounts and working papers at the start of our audit. We identified no material errors within the financial statements and received excellent support from NHS Highland's finance team.

The financial targets for the year were met although this was achieved through a capital to revenue transfer of £2.5 million and one off savings.

Between 2017/18 and 2019/20 NHS Highland estimate savings of £100million will be required to meet the statutory targets. This will be extremely challenging based on track record and the annual 60% ceiling on non-recurring savings that NHS Highland are struggling to break through. Given the challenges it will be critical that strong governance is in place as difficult decisions will be required.

Savings are planned to come via the ambitions set out in the Quality and Sustainability strategy, and through the Highland Quality Assurance framework. However, this is built on significant service redesign which may be lengthy and complex and there is a

Lastly, whilst achieving these savings NHS Highland need to continue to focus on improving patient outcomes and meeting performance targets.

For and behalf of Grant Thornton UK LLP
27 June 2017



The Financial Statements Audit



Our audit plan was presented to the Audit Committee on 13 December 2016. We have not altered the audit approach we set out in that plan.

As planned we reviewed and increased our materiality to £10.7million following receipt of the unaudited annual report and accounts, which included the Argyll and Bute Integrated Joint Board transactions for the full year.

We had a complete draft annual report and accounts and working papers at the start of our audit in accordance with the agreed timetable. We received excellent cooperation from the NHS Highland’s finance team and will work together to improve the efficiency of the audit process for 2017/18 reflecting on lessons learned from this first year of our audit appointment.

We identified no material errors within the draft annual report and accounts and a summary of the corrected adjustments and material disclosure changes is set out in Appendix A.

There is one unadjusted item within the financial statements which the Board is unable to correct due to the nature of its fixed assets register which is set out on page 9 of this report.

Internal Control Environment

During the year we have sought to understand NHS Highland’s overall control environment as related to the annual report and accounts. In particular we have:

- considered procedures and controls around related parties, journal entries and other key entity level controls;
- performed procedures around IT general controls; and
- performed walkthrough procedures on key controls around identified risk areas.

Our work identified no material control deficiencies. However we consider there is scope to further enhance the general IT controls in a small number of areas such as user access controls and testing the disaster recovery processes. We reported these to management in a separate IT issues memorandum and have agreed an action plan to address the recommendations.

Internal Audit

As set out in our plan, we have not placed formal reliance on the work of your Internal Auditors Scott-Moncrieff during 2016/17.

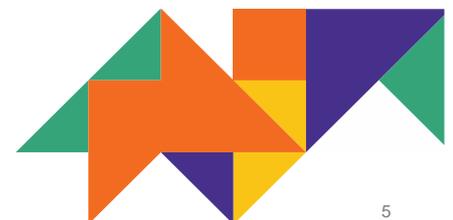
We have undertaken an overview of the Internal Audit provision as this has a key role in the overall control environment and we are satisfied with the internal audit arrangements and with the engagement from the Audit Committee.

During the year we have considered Internal Audit’s findings, and considered whether any recommendations would impact on our planned work. No areas were identified which caused us to consider our risk assessment. Internal Audit’s annual opinion was:

“In our opinion, NHS Highland has a framework of controls in place that provide reasonable assurance regarding the organisation’s governance framework, effective and efficient achievement of objectives and the management of key risks, and proper arrangements are in place to promote value for money and deliver best value.”

The findings of internal audit do not disagree with our knowledge and understanding of NHS Highland as an organisation and its risk profile.

Overall, the internal audit service has reported to management that it complies with Public Sector Internal Audit Standards and has sufficient resources and budget to deliver an annual opinion. For 2017/18 the number of internal audit days has been reduced slightly but we are comfortable this is consistent with internal audit activity at other larger NHS Boards and there is no impact on the programme of activity planned and this continues to be aligned to areas of risk.



Our identified Audit risks

Our audit plan identified a number of significant and other audit risks and our planned approach. We have set out below a summary of the work undertaken over these risks and our conclusions.

Audit plan identified risk and work completed	Our conclusion
<p>Management override of controls Under ISA (UK&I) 240 there is risk that the risk of management over-ride of controls is present in all entities (fraud risk).</p> <p>Work undertaken: Completed walkthroughs of the controls and procedures in place around journal entries</p> <p>Reviewed the key accounting estimates, judgements and decisions made by management</p> <p>Tested journal entries with a focus on unusual posting sources, times or amounts identified using our IDEA data analysis software</p> <p>Reviewed unusual and/or significant transactions.</p>	<p>Key accounting estimates: We did not identify any significant areas of bias in key judgements by management and judgements were consistent with prior years.</p> <p>Key accounting estimates we have considered are:</p> <ul style="list-style-type: none"> • the pensions disclosures for staff who transferred from Highland Council and therefore remain under the Local Government pension arrangements; • provisions; • property, plant and equipment revaluations; and • depreciation. <p>We are satisfied the judgements that have been made are reasonable and based on available information.</p> <p>Total provisions at 31 March 2017 were £55 million, compared with £40 million in 2015/16. The most significant increase related to clinical and medical negligence claims. These are managed by the Central Legal Office. We sought to understand NHS Highland’s arrangements for accounting for claims and the classification of claims and associated legal costs, and are comfortable this is consistent with prior year and informed by the information received from the Central Legal Office.</p> <p>Depreciation of circa £13million was provided for in the year. We are satisfied that the basis on which depreciation has been calculated is reasonable, has been used consistently and is in accordance with NHS Highland’s accounting policies.</p> <p>Journals: We made inquires related to inappropriate or unusual activity of those members of staff who can post and authorise journals with no concerns noted. We confirmed completeness of journals by agreeing the totals back to the trial balance. Agreeing completeness of journals for the full year was a difficult process and we will work with NHS Highland to improve this for 2017/18.</p> <p>Our audit work targeted large and/or unusual journals in particular journals which were material and we did not find any issues or invalid journals.</p> <p>Through our substantive audit testing we did not identify any significant transactions outwith the normal course of business for NHS Highland.</p>

Audit plan identified risk and work completed	Our conclusion
<p>The revenue cycle includes fraudulent transactions</p> <p>Under ISA 240 (UK&I) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. We do not believe it is appropriate to rebut the revenue recognition risk.</p> <p>Work undertaken:</p> <p>Completed walkthrough of the controls and procedures in place around sales invoicing and sales ledger</p> <p>Agreed other revenue to cash receipts in the year / post period end to gain comfort over validity of these transactions</p> <p>Considered the recoverability of any outstanding balances at year end.</p>	<p>We have found there to be appropriate policies and procedures in place for the management of income and receivables. Our walkthrough procedures confirmed that the control environment in relation to income and receivables is designed as intended.</p> <p>Our sample testing of other revenue found all sample items to be valid income and in line with the purposes of NHS Highland (regularity).</p> <p>We undertook substantive testing on income pre and post year end and can confirm that all transactions were accounted for in the correct accounting period.</p> <p>No issues were noted from our review of the treatment of income in the year, which has been accounted for in line with the NHS Manual for Accounts.</p> <p>We agreed the amounts recorded in the accounts to the final allocation letter from Scottish Government and to bank. Given the nature of funding from Scottish Government we rebutted the risk of fraud around this specific revenue stream, as set out in our audit plan.</p>
<p>Accounting for Argyll & Bute Integrated Joint Board</p> <p>Being the first full year of operation, material costs for the IJB to the 31st of March 2017 are required to be consolidated within NHS Highland's 2016/17 accounts. There is a risk that the consolidated balance may be materially misstated as at 31 March 2017.</p> <p>Work undertaken:</p> <p>Reviewed the proposed accounting treatment in line with IFRS 11 and other relevant guidance.</p> <p>Agreed the figures to the budget produced for the IJB and confirmed the year end position to third party confirmation.</p> <p>Reviewed the consolidation process.</p>	<p>The Argyll and Bute Integrated Joint Board is correctly accounted for in the NHS Highland accounts as a joint venture, in agreement with the NHS Manual for accounts. The IJB accounts are prepared on a local authority basis and therefore we not prepared and available at the time of our audit. We sought to understand the arrangements in place between the IJB and NHS Highland and the available data to support the accounting entries.</p> <p>A total of £199 million income and £204 million expenditure related to the IJB is accounted for in the NHS Highland annual report and accounts. Money has been passed to the IJB in accordance with the IJB Directions agreed and the budget agreed at the start of 2016/17. At the year end the IJB had an underspend of £440,000 of which £220,000 (a 50% share) is attributable to NHS Highland.</p> <p>We are satisfied that the transactions with the IJB are fairly recorded in NHS Highland's annual report and accounts.</p>

Audit plan identified risk and work completed	Our conclusion
<p>Completeness of operating expenditure</p> <p>Operating expenses are understated or not recorded in the right period. This also relates to Practice Note 10 (revised) which outlines that auditors should also consider the risk that misstatement may occur by the manipulation of expenditure recognition (Fraud risk).</p> <p>Work undertaken:</p> <p>Completed walkthrough of the controls and procedures in place.</p> <p>Reconciled creditors ledger to the general ledger and financial statements.</p> <p>Performed cut-off testing on pre year end and post year end transactions to gain comfort around the completeness and accuracy of recognised expenditure.</p> <p>Gained comfort around the regularity of expenditure and the application of public funds in accordance with the FReM and Scottish Public Finance Manual (SPFM).</p>	<p>We have concluded through the performance of our year end procedures that 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.</p> <p>Through our substantive pre and post year end cut off testing we did not identify any expenditure that was incorrectly accounted for.</p> <p>We have assessed completeness of expenditure through agreement of balances to signed third party confirmations required as part of SFR 30 (Balances with other NHS Scotland bodies). We did not identify any exceptions from our testing.</p> <p>Although some one-off measures were used, the financial targets in the year were all achieved.</p>
<p>Valuation of Local Government Pension Fund Net Liability</p> <p>NHS Highland participates in the Local Government Pension Scheme for staff transferred from Highland Council. The pension fund asset and liability represent significant estimates in the accounts with a risk they are materially incorrect.</p> <p>Work undertaken:</p> <p>Documented the process put in place by management to ensure the pension fund liability was not materially misstated.</p> <p>Reviewed the competence, expertise and objectivity of the actuary who carried out the pension fund valuation.</p> <p>Understood the basis on which the IAS 19 valuation was carried out, and confirming the reasonableness of the actuarial assumptions made.</p> <p>Checked the consistency of the pension fund figures in the accounts with the actuarial report.</p>	<p>Our audit work has not identified any issues in respect of the pension fund net liability.</p> <p>We have assessed the competence, expertise and objectivity of the actuary and the assumptions that were made were within the ranges we would expect.</p> <p>The total deficit on the balance sheet at 31 March 2017 was approximately £10million (compared to £1.038 million in 2015/16) and the Scottish Government has confirmed that it will meet these pension liabilities as they become due.</p>

Audit plan identified risk and work completed	Our conclusion
<p>Property, Plant and Equipment revaluation</p> <p>NHS Highland own a significant number of properties across a large geographical area, and revalue 20% of properties on a rolling basis. There is a risk that the revaluation is incorrectly accounted for and/or impairments are incorrectly treated.</p> <p>Work undertaken:</p> <p>Reviewed management's processes and assumptions for the calculation of the estimate.</p> <p>Reviewed the competence, expertise and objectivity of the management expert used.</p> <p>Reviewed the instructions issued to valuation experts and the scope of their work.</p> <p>Reviewed and challenge of the information used by the valuer to ensure it was robust and consistent with our understanding.</p> <p>Tested revaluations made during the year to ensure they were input correctly into the asset register.</p> <p>Reviewed the indexation for those assets not revalued during the year.</p>	<p>We have satisfied ourselves that the revaluations are fairly reflected in the Board's financial statements by completing our testing as set out.</p> <p>NHS Highland has a rolling programme of revaluations and an independent valuer revalues approximately 20% of its assets (Land and Buildings) each year. The values of those assets (Land and Buildings) that were not part of the formal revaluation for 2016/17 were reviewed and, where appropriate, were revised in accordance with the indices supplied by the valuer. This required some asset values to be uplifted by 4%.</p> <p>However, as reported by NHS Highland's previous external auditors, the fixed assets register does not allow for a percentage increase to be added as it can only accept round figures.</p> <p>Revaluations are therefore entered onto the system using an approximation for the percentage increase. As management cannot input the exact revaluation NHS Highland adopts a prudent approach and enters valuation below the 4% rather than above it.</p> <p>The difference is circa £300,000 on a balance in excess of £300million. See appendix 1 for unadjusted differences.</p>

The narrative elements of your annual report and accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding of NHS Highland and the financial information set out in the accounts, alongside Audit Scotland’s good practice guide issued in May 2017, and have set out our observations below:

Performance Report

The report outlines that NHS Highland has met its statutory financial targets for the year and is transparent about the one-off measures that were needed to achieve this.

The report outlines the performance in the year and highlights the key issues and risks facing NHS Highland. These are in line with our understanding and expectations.

There is good use of data boxes and cases studies to illustrate points which are clear and easy to read

Audit Scotland have produced a good practice briefing on performance reports and the Board should review this before producing its 2017/18 Annual Accounts and Report to identify any further enhancements.

Action Point 1.

Annual Governance Statement

The required elements have been included within the corporate governance report and the report itself is in line with our expectations.

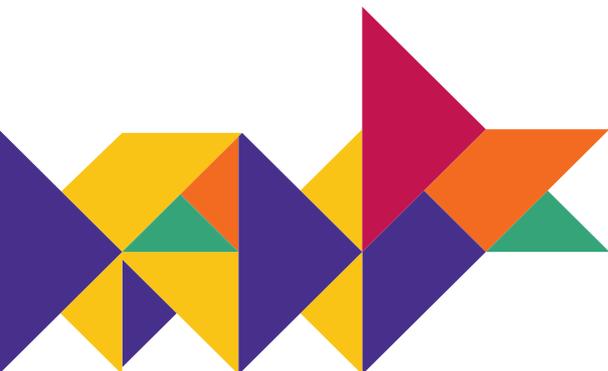
Each Director has completed an annual assurance return, and also each Committee has completed an annual report. These documents were presented to the May Audit Committee to inform the Committee’s review of the draft Governance Statement, which is in line with good practice.

There were no significant or material deficiencies that we were aware of that need to be reflected in the report.

Remuneration Report

The remuneration report has been completed in line with guidelines and the FReM and SPFM.

We have audited the financial information included in the remuneration report and have no matters we wish to bring to your attention.



We consider other aspects of your annual report and accounts, in particular key areas of judgement. We have summarised below our observations in these key areas:

Accounting Policies

- Accounting policies are in accordance with the NHS Manual of Accounts and we consider these to be appropriate to NHS Highland.

Accounting estimates and judgements

- We have identified and gained sufficient assurance over the following key estimates and judgements:
- Provisions (total value at 31 March 2017: £55million)
- Property, plant and equipment (PPE) revaluations (PPE net book value at 31 March 2017: £325million)
- Depreciation (total charge in 2016/17 £13million)
- Local Government Pension Scheme Net Liability (net liability at 31 March 2017: £10million)

Going Concern

- NHS Highland has an agreed budget for 2017/18 and continues to discuss future funding with Scottish Government in line with their Quality and Sustainability strategy.
- NHS Highland has no reason to not account on a going concern basis given the ongoing dialogue with the Scottish Government Health and Social Care Directorate; and the need to continue to provide health and social care services to the NHS Highland population.

Timing of transactions and period in which they are recorded (Cut off assertion)

- Through our substantive audit testing we did not identify any concerns over timing of transactions or the period in which they were recorded.

Impact on the financial statements of any uncertainties

- No uncertainties have been identified which have an impact on the final annual report and accounts.

Financial management



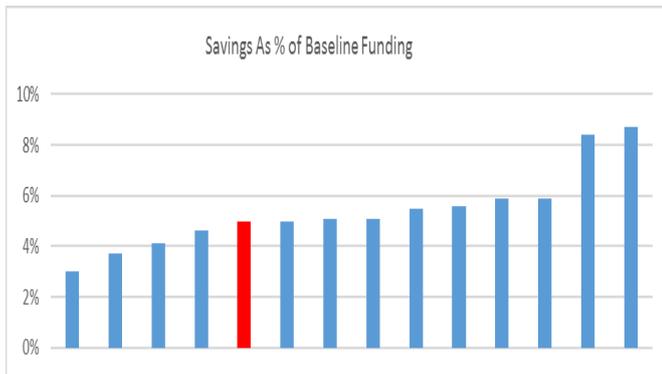
Financial management

Wider scope area of focus identified	Conclusion
<p>Financial management to achieve financial targets in 2016/17</p> <p>At its January 2017 meeting, the Board considered a paper on financial position for the nine months to December 2016.</p> <p>The Board faced an overspend of £3.6 million, although continued to forecast breakeven by the financial year-end.</p> <p>In order to achieve the RRL financial target, NHS Highland had to deliver the Operational Recovery Plan in the remainder of the financial year.</p> <p>Work undertaken:</p> <p>Discussions with the Director of Finance and Finance team during the year on the Board’s financial position</p> <p>Review of finance information submitted to the Scottish Government through monthly monitoring returns</p> <p>Review of Board finance papers and the level of detail and analysis provided</p>	<p>The Board’s financial plans for 2016/17 were acknowledged as being challenging throughout the year and were reliant on the achievement of savings plans which were expected to be achieved in the second half of the financial year.</p> <p>The financial reports to the Board throughout 2016/17 showed that the actual financial performance month on month compared to budget were always tracking over budget until the last quarter, but that the risks were known and identified and given the profile of anticipated savings an overall position of breakeven was still forecast and ultimately delivered at the end of the year.</p> <p>The profile of the saving plans makes accurate financial forecasting difficult as a number of savings are planned to be delivered later on in the year. However, the risks associated with the various savings plans are set out in the Board papers alongside planned remedial action where necessary.</p> <p>The savings were achieved through the application of NHS Highland’s transformation plan which looked to reduce expenditure on staff costs and increase efficiency by reducing the average length of stay wherever possible. Staff turnover increased in the year and one-off savings were achieved due to gaps between staff leaving and them being replaced – or the post being declared no longer required.</p> <p>Lastly, NHS Highland received approval from the Scottish Government Health and Social Care Directorate to transfer £2.5million from capital to revenue in the last quarter of the year.</p> <p>Ultimately NHS Highland achieved its financial targets for the year, delivering a small underspend (£111,000).</p> <p>NHS Highland acknowledges that the use of one-off measures and non-recurring savings is not sustainable in the longer term and this is articulated in its future medium term plans as laid out in the Quality and Sustainability strategy approved by the Board in May 2017. Action point 2.</p>

Financial position in 2016/17

NHS Highland’s 2016/17 performance report stated that it was the most challenging financial year to date. A savings target of £28.8million for 2016/17 was set as part of the revenue financial plan approved by the Board in April 2016. This equated to around 5% of its baseline funding. The Local Delivery Plan (LDP) recognised that there were risks associated with a savings target of this magnitude.

Although the savings target for 2016/17 was significantly higher than the savings target of £16.1million in the previous year, it was at the lower end of the targets of the other Territorial Boards in Scotland (% of baseline funding) as reported by Audit Scotland in the NHS Overview report October 2016:



By the end of the 2016/17 financial year, £22million of savings had been achieved. Although this was below the original target of £28.8million, it was approximately 40% higher than the savings achieved in the prior year.

Of the £22million savings achieved, £13million (60%) were achieved on a non-recurring basis. This is in line with the ratio of recurring/non-recurring at NHS Highland since 2011/12.

This means that savings of £13million will need to be achieved again in 2017/18, and this is before taking into account new additional savings required to achieve NHS Highland’s statutory targets.

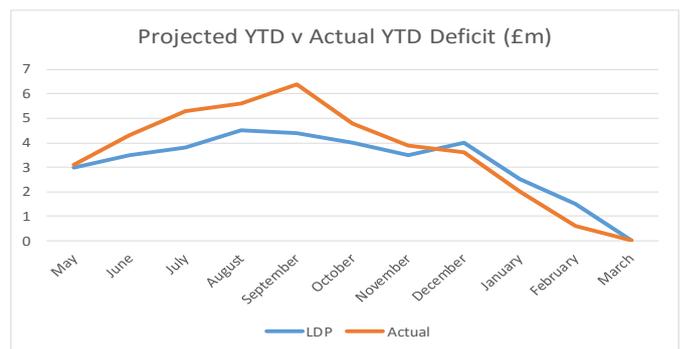
Financial performance against targets

NHS Highland met all of its financial targets in 2016/17:

	Target £m	Actual £m	Under £m
Core Revenue Resource Limit (RRL)	664.513	664.402	0.111
Non-core Revenue Resource Limit	36.769	36.769	0
Capital Resource Limit (CRL)	12.264	12.264	0
Cash requirement	715.968	715.968	0

The LDP for the year projected a break-even position at the year end, with an underlying deficit at the start of the year before the savings plans began delivering the expected results phased across the latter half of the year.

The expectations per the LDP compared to the actual performance is shown below.



The profile of the LDP, with savings plans taking time to deliver, poses additional risks to NHS Highland as any slippage is potentially unlikely to be recoverable at a later stage and confidence around breakeven is only realised in the last quarter of the financial year. **Action Point 2.**

	Year to date budget to actual spend reported
April to June 2016 Reported to July Board	£4.3million overspend
April to August 2016 Reported to September Board	£5.6million overspend
April to October 2016 Reported to November Board	£4.9million overspend
April to December 2016 Reported to January Board	£3.6million overspend
January to February 2017 Reported to March Board	£0.6million overspend
Actual out-turn	£0.01 underspend

Reporting financial performance

Regular finance reports are presented and discussed at the Board. Direct reporting to the Board is in line with our expectations given the importance of achieving the statutory limits set by the Scottish Government.

The financial reports produced are detailed and provide a comparison against the budget for both pay and non-pay expenditure as well as comparison with the savings plans.

Information of performance against the capital budget is included within the Board report. A more detailed analysis of the spend against the capital programme in year is considered by the Asset management group. The minutes and actions from the Asset management group are reported separately to the Board.

The Board reports contain a glossary of terms which is really helpful in communicating messages to the Non-Executives who do not have a finance background.

Financially 2017/18 will be challenging and there is therefore merit in consulting with the Board on what information would be helpful going forward and whether the level of detail and format continues to be useful to support strategic oversight and decision making.

Action Point 3.

Financial Capacity

The Director of Finance will be leaving NHS Highland at the beginning of July 2017. The post has been advertised and we understand that interviews are planned and that an appointment will hopefully be made. In the intervening period the Deputy Director of Finance will be the interim Director of Finance to ensure finance continues to remain a focus for NHS Highland. This will lead to a short term reduction in capacity within the finance team. **Action Point 4.**

The prevention and detection of fraud and corruption

The National Fraud Initiative (NFI) is a counter fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and the National Audit Office to identify fraud and error.

We found NHS Highland's arrangements for participation in the NFI were satisfactory. For 2016/17 there was a delay in the receipt of payroll to creditor matches due to a Scotland-wide issue impacting all Boards related to the uploading of payroll data.

We are of the view that NHS Highland has an appropriate plan in place to progress with the NFI exercise and respond to outcomes. All 'matches' identified by the NFI exercise are reviewed by relevant staff and then undergo a final review by a more senior member of staff. Matches are prioritised so that the more significant ones are investigated and resolved first.

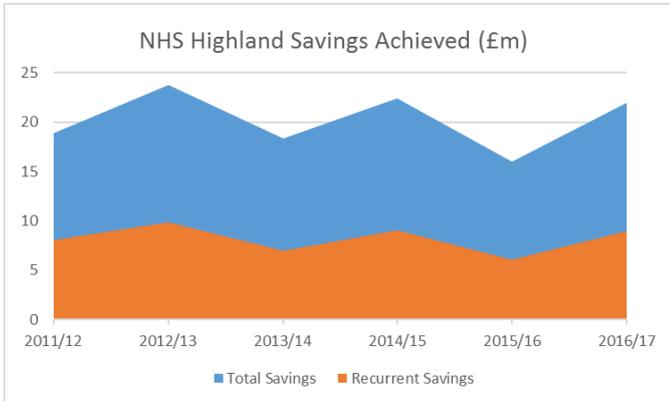
The NFI exercise is given sufficient support and attention via consideration at Audit Committee meetings including making use of the NFI checklist for Audit Committees included in the NFI published report.

Financial Sustainability



Wider scope area of focus identified	Conclusion
<p>Financial Sustainability in 2017/18 and longer-term</p> <p>NHS Highland recognises that it operates with an underlying financial deficit.</p> <p>Ongoing expenditure exceeds income and breakeven has only been achieved for a number of years by using non-recurring savings.</p> <p>Work undertaken:</p> <p>During the year we have had a number of discussions with the Director of Finance related to financial and service sustainability</p> <p>We have reviewed the various 2017/18 budget setting papers that have been to the Board</p> <p>We have considered NHS Highland’s record of delivering against saving plans in prior years</p> <p>We have considered the draft Local Delivery Plan</p> <p>We have considered the nature of the savings delivered to date, in particular the balance of recurring/non – recurring savings.</p>	<p>NHS Highland’s LDP identified that savings for 2017/18 of £47million are required and, as at June 2017, approximately one third (£14 million) of these had not yet been identified.</p> <p>Financial savings for 2017/18 are split as:</p> <p>Corporate/Central - £11.93million Highland Health and Social Care Partnership - £32.34million Argyll and Bute Integrated Joint Board - £6.5 million (only health elements of the budget)</p> <p>As at June 2017, £13.76million was still needing to be identified within the Highland Health and Social Care Partnership; and £0.9million related to the IJB. The savings targets are split out for the partnership and corporate across the 7 themes, with the majority falling under the umbrella of local initiatives and quality improvement.</p> <p>This represents a significant risk to NHS Highland in terms of ensuring financial sustainability for 2017/18 and continues to be an area of priority.</p> <p>The focus for NHS Highland is on service re-design, which will lead to recurrent savings. However, there is a significant risk that the planned service re-design may be a lengthy, complicated process and will not therefore deliver financial savings to the exact value or timing anticipated within NHS Highland’s plans.</p> <p>The Delivering Financial Balance Programme Board will continue to play a key role in terms of oversight during 2017/18 but it will take a more programme-based approach to overseeing the delivery plans, reviewing the continued progress towards breakeven throughout the year. This will be supported through the preparation and monitoring of specific project plans. Additional remedial action to ensure delivery will be initiated and reported to the Board.</p> <p>Monthly financial monitoring reports will continue to be provided to the Scottish Government Health and Social Care Directorate.</p> <p>Recognising service redesign plans take a longer period to deliver, this doesn’t necessarily neatly correlate to meeting annual statutory financial targets alongside meeting the suite of performance targets and improved patient outcomes.</p>

The chart below illustrates the total savings that have been achieved since 2011/12 by NHS Highland and the proportion that have been achieved on a recurrent basis.



Although significant levels of savings have been achieved year-on-year since 2011/12, approximately 60% have been delivered on a non-recurrent basis and there is almost a recurrent savings ‘ceiling’ that NHS Highland has been unable to break through.

Financial position for 2017/18 and beyond

It is widely recognised that the NHS is experiencing unprecedented financial pressures and these are expected to continue for the foreseeable future.

An ageing population across Scotland will create additional demand pressures in particular health and social care. Cost pressures are forecast to continue, with treatment becoming more complex and expensive year-on-year resulting in increased drug costs. As set out in the Quality and Sustainability strategy the change in demographics is clearly set out, and NHS Highland outlines its plans in relation to realistic medicines.

In the absence of a clear medium term financial framework for the NHS effective medium term financial planning is significantly restricted.

As part of the service re-design process, NHS Highland needs to ensure that the plans are affordable over the medium term and allow a degree of future flexibility. However, NHS Highland have a number of PFI schemes which given the nature of these facilities usage cannot be easily changed and/or NHS Highland are constrained around what flexibility they have over these facilities.

It is also important for the Board to be in a position to assess how well the re-designed services are meeting their objectives and to be able to respond promptly to any areas of under-performance.

Staffing within the NHS

In February 2017 Audit Scotland issued a briefing report on the workforce of the NHS.

This stated that around 55% of NHS spending in 2015/16 was on staff costs. The following four areas have been highlighted as key challenges for the whole of the Scottish NHS workforce:

Area	Key Messages	NHS Highland commentary
Vacancy rates	These have been increasing among some groups of NHS staff. Whilst some Boards have used staff turnover as a way of managing cost pressures, in other cases it has led to a higher spend on agency staff.	NHS Highland had the fourth highest vacancy rates of the fourteen boards in 2016. Trend analysis shows that, in general, the more rural the area the higher the vacancy rates.
Turnover rates	Turnover rates have increased nationally since 2012, leading to an increase in recruitment and training costs.	NHS Highland had above average turnover of 8% (nationally 6.4%) which would be expected to lead to higher recruitment and initial training costs.
Sickness absence	Sickness absence rates have increased nationally over the last few years, although they vary significantly across Boards. The national sickness absence target is 4%. Higher sickness absence could lead to a higher risk of unsafe staffing levels or an increase in staff costs if not managed effectively.	NHS Highland had a sickness absence rate of 5.1% compared with the national average of 5.2%. The sickness absence target across Scotland is 4%.
Ageing workforce	There is a trend towards an increasingly ageing workforce, with 38% of Scottish NHS staff being over the age of 50 in 2016, compared with 34% in 2012. An ageing workforce leads to higher retirement rates, which will increase the demand for new trainees to enter the workforce.	Similar to other NHS Boards, NHS Highland has experienced an ageing workforce. This is starting to come down slightly due to retirements and the recruitment of new nurses. However, as reported if NHS Highland struggle to recruit nurses this younger workforce won't necessarily materialise and over the medium to longer term the workforce will still be getting older.

Governance and transparency

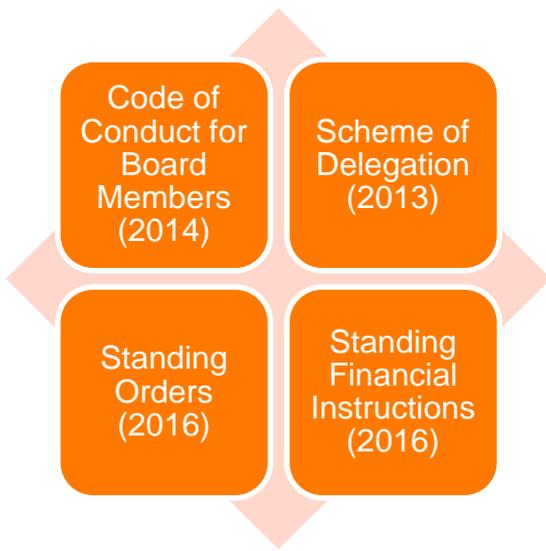


Governance and transparency

Wider scope area of focus identified	Conclusion
<p>Governance</p> <p>The Argyll & Bute Integrated Joint Board became operational in April 2016 and our risk assessment noted that the increasing use of partnership approaches to deliver services means that governance arrangements may become increasingly complex. There is a risk that the opportunities and potential benefits of working together may not be achieved.</p> <p>Work undertaken:</p> <p>Reviewed IJB constitution. Assessed the extent of publicly available information.</p> <p>Reviewed the independent governance report and identified the key recommendations relevant to the IJB.</p> <p>Reviewed progress in implementing agreed recommendations.</p>	<p>The Integrated Joint Board (IJB) meets bi-monthly and comprises four elected councillors from Argyll and Bute Council, four NHS Highland Board representatives and eight members who have been appointed from a range of sectors and stakeholders.</p> <p>Meetings are open to the public and the relevant papers are also available on the NHS Highland website.</p> <p>There is a code of conduct for members of the IJB.</p> <p>In late 2015/16 NHS Highland commissioned an independent review into its governance arrangements by Polley Solutions Ltd. This review identified two important issues that are relevant to the IJB which need to be addressed:</p> <ul style="list-style-type: none"> • review of the remits of the governance committees to minimise duplication of papers and discussions and clarify the roles of and relationships between the Board and its committees; • a renewed focus by the Board on the governance framework to be used by it to ensure that it continues to fulfil its responsibilities for both health and social care functions after 1st April 2016. <p>The Board agreed with the findings within the report and developed an action plan to address the issues raised. Progress against this action plan is reported as a routine agenda to each Board meeting. Given the nature of the actions some of these are ongoing, and continue to be discussed.</p> <p>Looking ahead to the 2017/18 audit, we will focus on the Board’s governance arrangements as they continue to evolve, in particular the Lead Agency arrangement in place between NHS Highland and Highland Council for North Highland.</p>

Corporate governance policies

NHS Highland has the core policies we would expect to see from a corporate governance perspective:



The Standing Orders and Standing Financial Instructions have been reviewed recently whereas the scheme of delegation in particular would merit updating. For example, the scheme of delegation refers to the Argyll & Bute Community Health Partnership but not the more recent Integrated Joint Board.

Some organisations collate all of their policies into a single ‘Governance Handbook’ which is can be helpful to staff and non-executive directors and also help avoid duplication as well as ensuring that all policies are kept under review at the same time. **Action Point 5.**

Committee structures

There are twelve separate committees of the Board. Of these, five are considered to be standing formal governance committees of the Board:



In addition to these governance committees, there are a further seven committees which routinely report to the Board during the year. These include: Endowments; Highland Partnership forum; Health and Safety; Area clinical forum; and Asset Management Group.

Board minutes and associated papers are publically available on the NHS Highland website. For the sub-committees the minutes are made formally available to the public as part of the Board pack of papers, with the individual Committee pages on the website not being updated. This could be made clearer on the website to enable the public to find information more readily. **Action Point 6.**

Audit Committee

The Chair of the Audit Committee was unavailable for part of the financial year and resigned from the Board in April 2017.

As a result, at one meeting the Employee Director deputised for the Chair, and then at the subsequent two another member of the Audit Committee chaired the meeting. A new chair has been appointed from June 2017 who has a financial background.

From our attendance at meetings we have noted there is a tendency for the meetings to be lengthy and at times stray into a greater degree of operational detail that is not necessary.

For 2017/18 there will be at least one new member to the Audit Committee therefore management should look to provide refresher Audit Committee training to the members, which we would be happy to provide and support. **Action point 7**

Committee Effectiveness

In February 2016 NHS Highland received the independent governance report it commissioned which contained a number of recommendations:

- A greater focus on the leadership as well as the performance scrutiny role of the Board and a better understanding of how these two roles differ so that both executives and non-executives recognise when it is necessary, and how, to re-examine and re-assess areas facing problems or poorer performance;
- Development of a performance framework that shows clearly the goals that the organisation is seeking to achieve in the five areas of its business – quality/safety, staff wellbeing, cost, performance/delivery and person/patient centred;
- A review of the remits of the governance committees to minimise duplication of papers and discussions and clarify the roles of and relationships between the Board and its committees;
- A renewed focus by the Board on the governance framework to be used by it to ensure that it continues to fulfil its responsibilities for both health and social care functions after 1st April 2016 when the legal framework for these integrated services changes.

The Board continue to implement the agreed action plan, and a number of the actions have been subject to detailed Board discussions around the best way forward. The action plan is reported to each Board, with some recommendations still classed as on-going, with one or two being further developed now that the Quality and Sustainability Framework is approved. **Action Point 8.**

North Highland Lead Agency arrangements

We noted through discussions with management and review of the May 2017 Board papers that future governance around the North Highland partnership continues to be discussed. This centres on the role of the Health and Social Care Partnership Committee and its strategic decision making powers and relationship with the Board. Discussions are also ongoing with Highland Council around future governance. We will review this early in 2017/18 as part of our external audit planning.

Accessibility

The Board meets a minimum of six times a year, typically bi-monthly, and the meetings are held in public.

The Board papers are available for download to the general public (subject to the usual restrictions), which promotes transparency.

Role of Boards

We submitted a return to Audit Scotland in June 2017 in relation to the Role of Boards as part of their wider follow up work in this area. It considered three key areas:

- are governance, decision making and scrutiny arrangements effective
- To what extent do non-executives and staff demonstrate high standards of behaviour
- To what extent do non-executives and staff receive sufficient training and development

This return has been agreed with the Director of Finance and the Board Chairman. There were no specific matters from this return we wish to highlight in this report other than to reiterate the Board needs to continue to focus on strengthening governance including filling the vacant Non-Executive posts, in order to be ready to recognise the challenges ahead.

Value for money



Performance Reporting

From a review of the performance information reported to the Board we noted that it is not always very detailed, particularly where a target is shown as red or missed, and what are the subsequent actions being taken to improve the performance.

Typically we would expect to see:

- a commentary on the reasons behind any performance being less than the target set;
- an indication of the overall direction of travel;
- an explanation for any data that was missing; and
- the action being taken to address the performance or data issues.

Performance is monitored across a number of measures and the most recent figures for 2016/17 as reported to the May 2017 Board meeting is:

Area	Number of Targets Reported	Number Met In 2016/17	Number Met In 2015/16
Health Improvement	4	2	3
Efficiency	3	2	2
Access to Services	14	5	3
Treatment (infection control)	2	0	1
Total	23	9	9

In many of the areas measured, the performance in 2016/17 was below the targets that had been set. The Board recognises that significant improvements in access to services can only be achieved through service redesign and it acknowledges that performance is unlikely to improve noticeably in the short term.

Performance management

NHS Highland has restructured to create a Business Support Services Directorate with a remit for planning and performance. A monitoring and performance framework has been established to underpin the annual and longer term plans reflected in the Quality and Sustainability strategy.

There are 2 main performance measures for NHS Highland – measuring performance integration where the data source is the national Information Services Division and then in respect of the quality and sustainability plan. Data around the quality and sustainability strategy comes from a number of sources, and also involves manual data collection.

New ways of delivering care need to be balanced across the whole health and care system. For example NHS Highland’s strategy is to deliver more care in the community and at home which should result in a reduced need for hospital inpatient care and therefore fewer beds. Resources will be released by closing the beds which are no longer required.

Part of NHS Highland’s quality and sustainability strategy will therefore be to measure key indicators demonstrating that the plans are being implemented.

Work is ongoing to prepare descriptions for each indicator and, as appropriate, any supporting data sources. We will review progress with this during our 2017/18 audit.

Annual Review by the Scottish Government

The September 2016 letter from the Scottish Government commenting on the 2015/16 Annual Review noted a strong performance, within a context of a number of challenges. The letter commented favourably on the plans for the integration of healthcare with social care.

However, it noted some areas where the performance was disappointing and these issues continued into 2016/17:

- waiting times – with significant pressures in certain services
- delayed discharges – although the integration work with the two local authorities in its area should help develop a strategy to address this.

Performance data and metrics are being reviewed and linked to the new performance management framework with a suite of data being available from ISD to support NHS Highland monitor performance targets closely during the year. **Action point 9**

Quality and Sustainability Strategy

NHS Highland has a really clear strategic framework as shown below.



The framework is easy to understand, is used consistently in papers and messaging to the Board and is cascaded throughout the organisation.

The link between strategic priorities to vision and values is made, and it underpins the significant work ongoing across Highland related to Lean and driving service and performance improvements which result in improved patient outcomes.

As recognised by management, this work has led to differing more streamlined processes, and it is taking the work undertaken across a number of project pilots and rolling out across NHS Highland. It is anticipated that these improvements will lead to cost improvements and/or direct savings but at this stage this is difficult to quantify and may take a longer period of time before they are realised.

NHS Highland has produced a Quality and Sustainability strategy, which reflects national and local priorities. This has been through various consultations with stakeholders and was approved by the Board in May 2017.

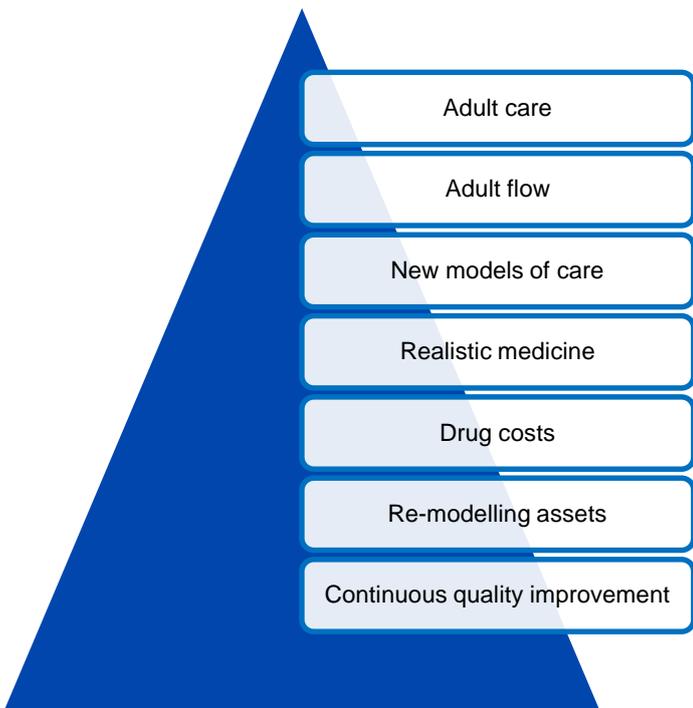
The document sets out:

- the strategic context;
- a case for change;
- NHS Highland approach;
- analysis on costs and spend; developing the three year plan;
- supporting strategies and the performance framework.

As a document it is lengthy but sets out a clear future direction; is supported by good analysis and consideration of risks and opportunities and includes financial analysis for 2017/18 through to 2020. What runs consistently through the document is the Highland Quality Assurance vision and how various strands interact and together will deliver NHS Highland's strategic vision.

The plan is explicit that existing models of health and social care delivery across NHS Highland is not sustainable.

Actions for 2017/18 centre on 7 themes:



The plan will be delivered alongside other standards and regulations such as through Care Inspectorate, Health Environment Inspectorate, Health Improvement Scotland, Health and Safety Executive, and the Scottish Public Services Ombudsman, wider feed-back and evaluation.

Measures such as infection control, Hospital Standardised Mortality Rates, service user feed-back through local and national initiatives will all be important measures to look at overall performance and progress.

Management and the Board recognise that changes are not necessarily linear in nature; and there are interdependencies which make it difficult to determine exactly when projects will be delivered and to what timescales. The seven initiatives relate back to People, Quality and Care and will support the reduction of waste, harm and unwarranted variation, allow new and evolving models of care to be introduced which in turn will reduce costs.

Implementing new models of care has been happening over the last couple of years at NHS Highland for example Caithness, Argyll and Bute mental health; Badenoch and Strathspey. In a number of cases these changes have been subject to consultations; and increased media and local challenge.

NHS Highland within the strategy set out the grounds for the change in service provision, and a number of instances this is down to ensuring safe clinical practices.

Appendices

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Audit Adjustments

Set out below is a summary of uncorrected and corrected misstatements.

Uncorrected misstatements

	SOCNE £000	Balance Sheet £000	SOCTE £000
The fixed assets register can only accept round sum amounts and approximations for all revaluations need to be used. Property plant and equipment values and the revaluation reserve are both understated by £300k. There is no impact on the reported revenue position for the year.		PPE Dr £300 Rev Reserve Cr £300	

Corrected misstatements

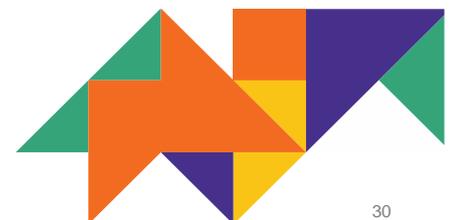
	SOCNE £000	Balance Sheet £000	SOCTE £000
None were identified			

Disclosure misstatements

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow the NHS Highland Audit Committee to evaluate the impact of these matters on the financial statements.

During the course of our audit process we identified some minor disclosure enhancements to the performance and accountability reports and the annual accounts. All recommended disclosure changes have been processed in the final audited annual report and accounts.

There were no material/significant disclosure misstatements identified we wish to bring to your attention.



Follow up on prior year recommendations

We have undertaken a follow up of the recommendation raised by the previous external auditors (Audit Scotland). The results of our work are outlined below:

Audit Scotland Recommendation	Grant Thornton Assessment	
<p>Accounts Production Senior management in the Board's finance team should ensure that a full set of unaudited accounts are provided to audit in accordance with the agreed timetable.</p>	<p>As noted earlier, a complete set of financial statements and supporting working papers were made available to us at the start of our audit.</p>	
<p>Pharmacy Accrual Officers involved in FHS pharmaceutical payments need to develop a robust understanding of this complex area.</p>	<p>Staff are now familiar with the basis on which the accrual is calculated and the accrual was supported by appropriate audit evidence and working papers.</p>	
<p>Annual Governance Statement The Board should adopt a formal approach to compiling the AGS to ensure it has all appropriate assurances and has fully disclosed any significant points.</p>	<p>As reported on page 10, the required elements have been included within the corporate governance report and the report itself is in line with our expectations. Best practice regarding assurance statements has been followed.</p>	
<p>Indexation Officers should liaise with the valuer to ensure that in future indexation is calculated in a way that is compatible with the Board's fixed asset register.</p>	<p>This issue arose again in 2016/17. This is because the fixed asset register can only accept round sum revaluations whereas the valuer deals in percentage changes across a range of assets. The Board has taken a prudent approach by rounding down the valuations and the difference is not material. Management has discussed this with the valuer but the issue is with the fixed asset register not the valuation and the register cannot be changed. It is unlikely this will result in a material adjustment and a prudent approach is taken.</p>	

 Fully implemented
  Partially implemented
  Not implemented

Audit Scotland Recommendation	Grant Thornton Assessment	
<p>Budget holders The Board should, as a matter of priority, ensure the appropriate training is delivered to budget holders to enable them to fully understand and address issues highlighted in the reports provided to them</p>	<p>Ongoing training is continuing for budget holders and an on-line module is available for all managers and staff.</p>	
<p>Agency Staff Costs The Board should reduce reliance on agency staff to maintain services.</p>	<p>The financial statements for the year ended 31 March 2017 show that agency costs have risen by approximately 6% in the year.</p> <p>The Board is aware of these costs and are actively exploring a number of measures and actions to reduce agency costs. On this basis we have marked the action as complete but will continue to review NHS Highland's plans and where necessary raise any further specific actions</p>	
<p>Workforce Planning The Board should make better use of techniques such as scenario planning and horizon scanning and should actively consider succession planning.</p>	<p>The national workforce planning reports are expected and will be used as a basis for local developments. The issues raised by Audit Scotland in their report on the NHS workforce in Scotland are also being considered</p>	
<p>Freedom Of Information Requests The Board should take action to ensure adequate resources are available to deal with FOI requests to enable the statutory delivery date to be met.</p>	<p>This has been actioned with resource under the remit of the Board secretary.</p>	



Fully implemented



Partially implemented



Not implemented

Action Plan for 2016/17

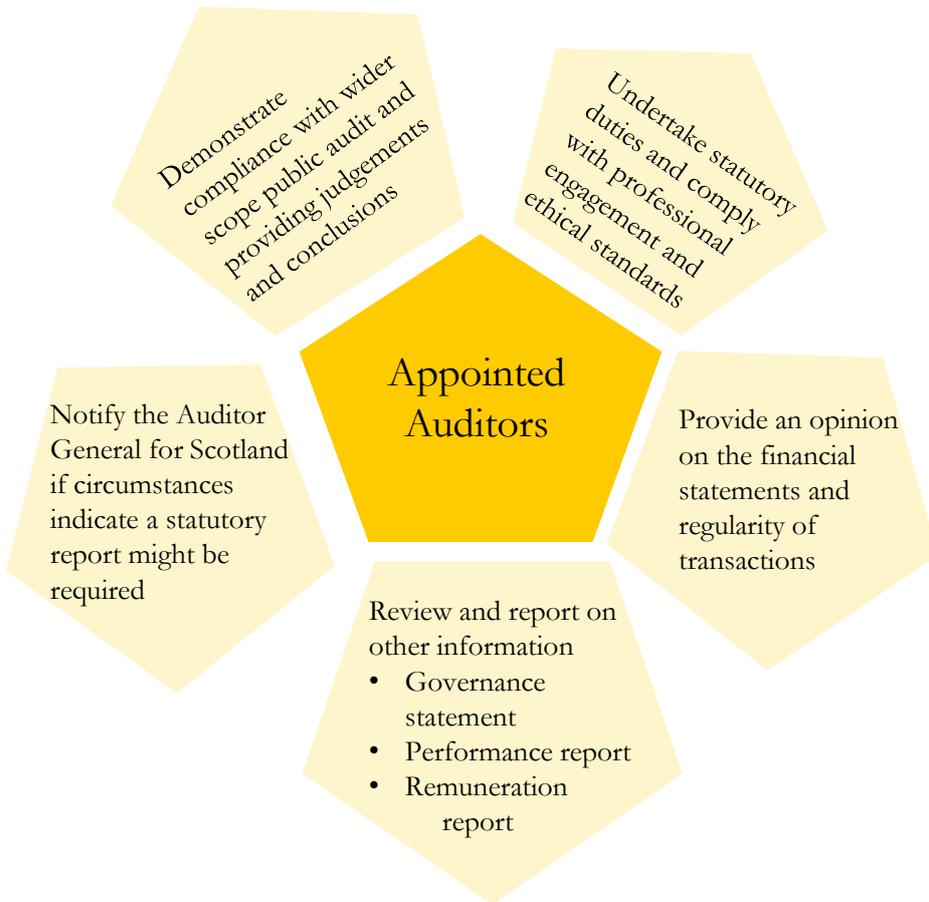
During the course of our 2016/17 audit work we have identified the following actions for management:

	Area	Recommendation	Priority	Management Response
1	Performance report	Management should review the Audit Scotland good practice briefing on performance and accountability reports before producing the 2017/18 Annual Report and Accounts. As part of this review, and linked to the planned improvements in performance management arrangements, management should reflect on how current performance is set out alongside future planned activities, to enhance reporting.	Low	Response This will be part of the planning for 2017/18 year-end process. Timescale March 2018 Action Owner Head of Area Accounting
2	Financial forecasting	From a review of NHS Highland's saving plans for 2017/18 and beyond, it is noted that these are explicitly linked to planned service re-design, and there are related risks that the service re-design may not happen at the pace anticipated to deliver the planned saving impacting on achievement of the statutory targets. NHS Highland management should continue to discuss the ongoing financial pressures with the Scottish Government, exploring options around longer-term financial sustainability over a period of years rather than the current one year focus.	High	Response Agreed that ongoing dialogue with Scottish Government would be helpful Timescale Ongoing Action Owner Director of Finance / Interim Director of Finance
3	Finance reporting	Management should take the opportunity to confirm that the Board receives all the necessary financial information in a useable format to support decision making during 2017/18, and they should explore whether additional commentary and narrative on the capital programme would be beneficial.	Medium	Response Financial reports to the Board – and one or two other committees – are being reviewed to ensure that they remain fit for purpose and will be revised where necessary. Timescale Early 2017/18 Action Owner Director of Finance
4	Financial capacity	Should there be a gap before the new Finance Director is appointed and starts, the Management team should continue to ensure the momentum is not lost around the financial position; financial forecasts and achievement of the savings plans.	Medium	Response Agreed. An interim DoF arrangement has been put in place. However, the key actions around the financial position and the achievement of savings plans lie with the whole management team, not just the DoF so there is not a 'person dependency' in this regard. Timescale until new DoF begins Action Owner Chief Executive

	Area	Recommendation	Priority	Management Response
5	Scheme of delegation	Update the scheme of delegation to reflect the Argyll & Bute Integrated Joint Board and to consider whether the various governance policies in place should be collated into a governance handbook.	Low	Response –Agreed Timescale – October 2017 Action Owner Board Secretary
6	Availability of Committee papers	Ensure all Committee pages on the NHS Highland website state that the most up to date information is now contained within the Board reports section	Low	Response – Agreed Timescale – August 2017 Action Owner Board Secretary
7	Audit Committee training	Following changes to the Audit Committee membership, provide refresher training during 2017/18.	Medium	Response: support for each member to be undertaken as required and external audit will support the committee in facilitating a session by end of December 2017 Timescale Ongoing Action Owner Head of Area Accounting
8	Governance review	Ensure that progress against the recommendations in the independent report on the governance arrangements that were in place are addressed and that progress is reported to the Board.	High	Response Agreed – recommendations are being progressed and it is anticipated that they will be concluded by December 2017. Timescale December 2017 Action Owner Board Chair
9	Performance management	Review the information reported to the Board to ensure it covers the key drivers for NHS Highland. Focus should be on new delivery arrangements and delayed discharges which was identified as an issue by the Scottish Government in the 2015/16 Annual Review.	Medium	Response Agreed – this is already underway with a performance framework document having been considered in draft by the Board in May 2017 and due to be considered for formal approval by the Board in September. Timescale September 2017 Action Owner Head of Planning & Performance

Reminder of Responsibilities

The Code of Audit Practice sets out responsibilities of the audited body (pages 10, 11 and 12) across: Corporate governance; financial statements and related reports; standards of conduct for prevention and detection of fraud and error; financial position; and value for money (as described in the Scottish Public Finance Manual). As appointed auditors our responsibilities are set out on page 13 and are summarised below.



An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks are only those that have come to our attention during our normal audit work in accordance with ISAs and the Code and may not be all that exist.

Communication of the matters arising from our audit work does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.





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