



Grant Thornton

# NHS Highland

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**External Audit Annual Report to the Board and the Auditor General for  
Scotland For the financial year ending 31 March 2018**

Board Meeting 26 June 2018

**Joanne Brown**  
Engagement Leader

**John Boyd**  
Senior Manager



# Our audit at a glance



We have fulfilled our responsibilities as set out in International Standards of Auditing (ISAs) (UK) and the Code of Audit Practice throughout our work and this final report addressed to the Board and the Auditor General for Scotland concludes our work.



We have performed sufficient audit testing around our identified area of significant risk including: management override of controls; risk of fraud in revenue recognition; the risk of fraud in expenditure recognition; and the valuation of property, plant and equipment.



We have raised a number of audit recommendations in particular around financial management and financial sustainability. We have followed up on prior year audit recommendations and are satisfied that these have been progressed although a number are still to be fully implemented

## An audit underpinned by quality



This report reflects our broader reporting obligations under the Code of Audit Practice. We have provided commentary against our specific wider scope risks as well as certain aspects of NHS Highland arrangements. Overall NHS Highland would have reported a deficit financial position as at 31 March 2018 if they had not received brokerage of £15million. Looking ahead there is a need for the Board to save circa £50million in 2018/19, and to date there is a shortfall in savings identified in the region of £19million - £23million. Future financial sustainability remains a significant challenge for the Board.



We received a good complete set of financial statements including the Performance Report, Accountability Report and Governance Statement.

Management continue to look to streamline and enhance the narrative in the front end of the Annual Report and accounts.



We have issued an unmodified opinion  
We have built on our relationship with NHS Highland management during the year and this has ensured an efficient audit process to allow for the audit to be concluded by agreed timescales.

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## Adding value through External Audit

First and foremost our objective is to ensure we deliver a quality external audit which fully complies with International Standards of Auditing (ISAs) UK and the Audit Scotland Code of Audit Practice (2016). By ensuring our audit is efficient and effective, underpinned by our approach to audit quality gives you assurance over our opinion.

Through this Annual Report we seek to provide insight and commentary over certain aspects of NHS Highland's arrangements, sharing relevant practices with the Audit Committee and Management.

We have continued to build on our working relationship with management and our understanding of NHS Highland as an organisation. During the year we have worked closely with management to understand the Board's financial position and support from Scottish Government Health and Social Care Directorate. We also undertook a review of certain primary/secondary care procurement and contract performance monitoring providing recommendations to management to enhance controls over procurement and contract monitoring.

Lastly we are committed to audit quality. We shared our Audit Scotland Transparency report with the Audit Committee and will share lessons learned on an annual basis, as our reporting in this area evolves.

# Introduction

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2018.

Our work has been undertaken in accordance with International Standards of Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016.

Our report is addressed to the Board of NHS Highland. In addition, in accordance with our reporting responsibilities the report is jointly addressed to the Auditor General for Scotland.

Once finalised this report will be made publically available on the Audit Scotland website ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk))

Our report was presented to the Audit Committee meeting on 26 June 2018, followed by a special meeting of the Board on the same date.

We would like to thank NHS Highland management and the finance team for an effective year-end audit process and all their support and assistance in the audit process throughout the year.

## Structure of this report

In accordance with the Code of Practice, in addition to our core financial statements audit we provide conclusions on the four dimensions of wider-scope public audit.

Our report is structured as follows:

Financial statements – Section 1

Financial management – Section 2

Financial sustainability – Section 3

Governance and transparency – Section 4

Value for money – Section 5



## Our Opinion

For the financial year ended 31 March 2018 we have issued an **unmodified audit opinion**

- True and fair view of the financial statements
- Regularity – expenditure has been incurred in accordance with the purpose of NHS Highland
- Other prescribed matters (which include the audited information in the remuneration report)



## The audit process

We received a good complete set of financial statements including the Performance Report and the Accountability Report, including the staff remuneration report and governance statement.

This was in line with the timetable we agreed.

The draft financial statements were supported by good working papers and our audit queries were quickly responded to.

We identified no unadjusted differences to report to the Audit Committee and the Board.

We identified minor disclosure adjustments within the financial statements and are satisfied these have been reflected within the financial statements. None of these were material or significant in nature.



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# Our audit of the annual report and accounts



Materiality is set at 1% of gross expenditure based on the 2016/17 audited financial statements (£8.7 million). Previous year it was 1% of gross expenditure. This was in accordance with our agreed audit plan.



The draft financial statements were of a good standard and in line with the new NHS accounts template.

The financial statements were supported through detailed working papers. There were improvements in the audit process this year and we will continue to work with management to enhance the audit process.



We have issued an unmodified audit opinion on the financial statements, including the wider information contained in the financial statements, and regularity opinion.

The audited parts of the Directors Remuneration Report are free from error.



Testing provided assurance on all identified areas of significant audit risks and there were no material audit differences arising during the course of our audit.

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## Audit approach and materiality

Our audit approach was set out in our annual audit plan presented to the Audit Committee on 19 December 2017. As set out in our plan, our materiality calculations were based on the audited 2016/17 financial statements. Overall materiality has been set at £8.721 million (1% of gross expenditure) and performance materiality is set at £6.54 million (75% of materiality). We report to management any audit difference identified over £250,000 (Trivial as 5% of materiality).

The draft financial statements were of a good standard supported through detailed working papers. There were improvements in the audit process this year and we will continue to work with management to enhance the audit process.

## Audit opinion

Based on our audit procedures performed have issued an unmodified audit opinion on the financial statements including:

- they give a true and fair view
- they have been properly prepared in accordance with relevant legislation and standards
- the wider information contained in the financial statements, e.g. Performance Report and Accountability Report, is consistent with the financial statements
- regularity of expenditure
- audited parts of the remuneration and staff report have been prepared in accordance with applicable guidance

## Internal control environment

During the year we sought to understand NHS Highland overall control environment (design) as related to the financial statements. In particular we have:

- Sought to understand procedures and controls around related parties, journal entries and other key entity level controls
- Performed procedures around entity level controls and there are no significant matters that we wish to draw to your attention.
- Performed walkthrough procedures on key controls around identified risk areas including revenue, expenditure and provisions.

No material weaknesses in the accounting and internal control systems were identified based on our work undertaken during the audit which could have an adverse impact on NHS Highland's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

We adopted a substantive based approach to the audit of the financial statements and therefore do our review is limited to the design of controls rather than the operating effectiveness of controls.

## Internal Audit

As set out in our external audit plan we have not placed formal reliance on the work of Scott-Moncrieff, the internal audit provider, during 2017/18. We have reviewed the internal audit plan and individual reports issued to date, to consider if any impact on our audit approach. For 2017/18, Internal Audit's opinion was reasonable assurance with caveats relating to the progress around GDPR, which has been reflected in the governance statement, and the progress in respect of internal audit recommendations (see our comments in governance)

## Key audit matters - Responding to significant risks

Within our annual external audit plan we identified significant audit risks and our planned approach. We have set out below a summary of the work undertaken over these risks and our audit conclusions

	Identified audit risk at planning	Work completed	Our conclusion
Risk of fraud in revenue	As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. £45.274 million is generated from income from charging schemes and other sources of income (not gran-in-aid related). We consider the risk to be prevalent around the year end and therefore focus our testing on cut-off of income.	<ul style="list-style-type: none"> <li>Developed our understanding of NHS Highland's material revenue streams including walkthrough of key transactions.</li> <li>Performed targeted review and testing of key revenue streams during the year, including analytical procedures and transaction testing</li> <li>Performing revenue cut off procedures and substantive testing over pre and post year end balances</li> <li>Testing the existence and recoverability of balances at the year end</li> </ul>	<p>From our audit procedures performed we are satisfied that revenue is free from material misstatement.</p> <p>We are satisfied that revenue has been recognised in the appropriate financial year.</p>
Operating expenditure is not treated correctly	Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As set out in Practice note 10 (revised) which applies to public sector entities. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of expenditure.	<ul style="list-style-type: none"> <li>Developed our understanding of NHS Highland's material expenditure streams including walkthrough of key transactions.</li> <li>Performing targeted review and testing of key expenditure streams during the year, including analytical review of expenditure and targeted transaction testing, including consideration of the regularity of expenditure incurred.</li> <li>Performing cut-off testing of expenditure transactions around the year end to ensure these had been allocated to the appropriate financial year. Reviewing post year end payments for any potential unrecorded liabilities.</li> </ul>	<p>Assurance gained that expenditure has been recorded within the appropriate financial year and that payables are free from material misstatement.</p> <p>We are satisfied that expenditure has been incurred in accordance with the type/nature of NHS Highland as an organisation</p>
Management override of controls	As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. Override of controls is present in all entities.	<ul style="list-style-type: none"> <li>Developed our understanding of the entity level controls in place at NHS Highland that reduce the risk of management override</li> <li>Performed review of journal transactions for unusual transactions or balances.</li> <li>Evaluated key areas of judgement within the Financial statements and the basis for these judgements / application of accounting policies</li> <li>Reviewed unusual and/or significant transactions</li> </ul>	<p>We did not identify any significant areas of bias in key judgements by management.</p> <p>We have not identified any unusual or significant transactions during the course of the year that would indicate management manipulation.</p> <p>Assumptions in this years financial statements are in line with prior year, and still considered reasonable.</p>

## Other key areas of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. Whilst not considered a significant risk, these are areas of increased risk due to their complexity or magnitude.

**Valuation of property, plant and equipment:** In accordance with the Government Financial Reporting Manual (FRM), NHS Highland holds property, plant and equipment and fair value. Valuations of land and buildings are reassessed by professional valuer's under a five-year programme, with adjustments in intervening years to reflect valuation movements since the last full valuation.

During 2017/18, NHS Highland continued with the rolling programme of revaluation of 20% of assets held. Other items of PPE were reviewed to ensure they continued to reflect fair value, and indexation applied to reflect market movement in value or impairment applied. We have reviewed the revaluation undertaken in year, including the work performed by external valuer, and are satisfied that property, plant and equipment have been appropriately recorded in the accounts.

**Defined benefit pension scheme:** NHS Highland participates in the Highland Council Pension Fund, a local government defined benefit pension scheme. The Board recognises the cost of retirement benefits when they are earned by these employees, rather than when the benefits are eventually paid as pensions. Highland Council recognises the liability at 1<sup>st</sup> April 2012 attributable to these NHS Highland staff in the Council accounts and any gain or shortfall in the value of the fund attributable to NHS Highland staff in year is charged to the Board. The movement in year is determined through actuarial valuation to determine the Board's share of costs.

We have reviewed the actuarial assumptions applied in the valuation and are satisfied that these are appropriate for NHS Highland.

## Narrative elements of your annual accounts

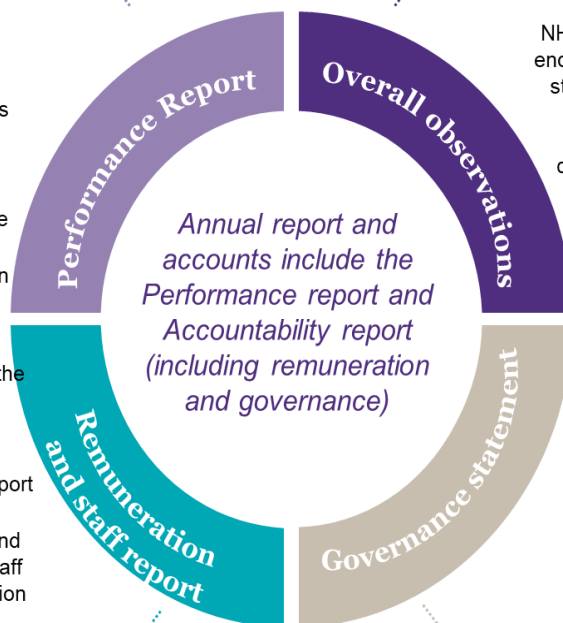
We have considered the consistency of this narrative with our understanding and the financial statements and have set out our observations below. We have also audited the required information in the remuneration report (marked audited) and have no matters we wish to bring to your attention.

### Performance Report

- The performance report provides a summary of key performance activity across the year
- The report summarises the key priorities for the year and key achievements and developments during the year
- NHS Highland has been transparent around underlying financial performance including brokerage received
- Good use of links to relevant material on the NHS Highland's website

### Remuneration and staff report

- Has been prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions thereunder
- The senior managers reflected in the report have been correctly identified
- We would recommend that NHS Highland encourage full disclosure of all senior staff and non-executive members remuneration information during the year.



### Overall observations

NHS Highland continue to look at how the "front end" of the Annual Report and Accounts tells the story of the Board as an organisation including strategic priorities, risks and challenges and opportunities. There are opportunities to continue to enhance reporting through greater use of graphics to support the readers overall understanding.

### Governance Statement

- The Governance statement is included in the Accountability report
- Governance Statement makes reference to areas of development across the Board's governance arrangements including GDPR compliance and underlying financial position.
- The statement is supported by individual assurances to the Accountable Officer over internal controls



## Key aspects of your financial statements

As set out in our audit plan we consider particular aspects of your financial statements in relation to management judgements including estimates and where management may have particular options or choices in what accounting standards or disclosure requirements to apply. We have summarised our conclusions below.

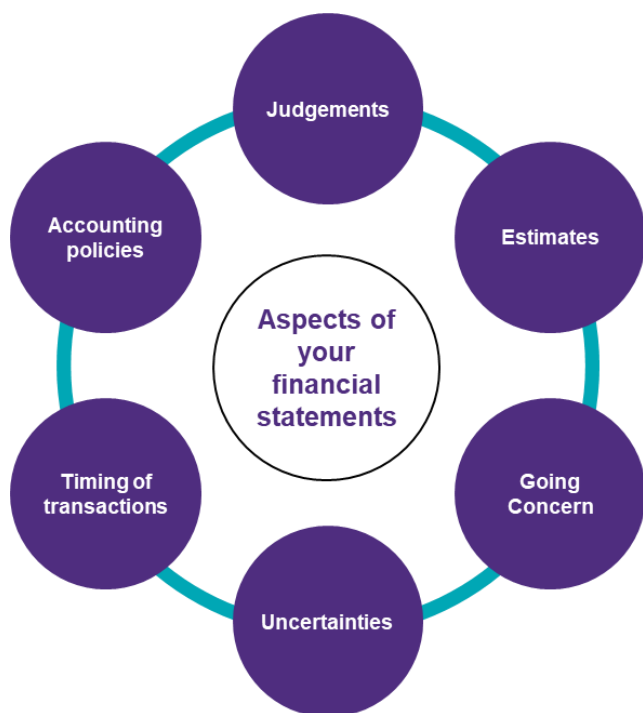
### Commentary:

NHS Highland's Accounting policies are in accordance with IFRS as interpreted and adapted by the 2017/18 NHS Manual for Accounts (where relevant to NHS Highland) and we consider these to be appropriate to the organisation and consistent with those adopted in prior years.

### Accounting estimates and judgements

NHS Highland significant accounting estimates and judgement impacting on the annual accounts are the following:

- property valuations: Where we are satisfied these are supported by qualified expert valuations.
- Pension scheme assumptions:
- Management use independent actuarial advice to support assumptions applied in actuarial valuation.
- Expected useful economic lives of property, plant and equipment. Management regularly consider the rapidly changing external environment when assessing useful economic life. We consider the useful economic lives adopted by management as appropriate.



We are satisfied that the estimates and judgements applied by management are reasonable and not subject to management bias.

### Going concern

- NHS Highland has an agreed budget for 2018/19 and a draft Resource Allocation letter from the Scottish Government.
- The outlook for 2018/19 is increasingly challenging for NHS Highland. Management have projected that savings will be required of £50.7 million in 2018/19 (compared with the targeted £48 million in 2016/17). The Board failed to achieve the required level of savings in 2017-18 and coupled with other in year financial pressures, required brokerage of £15 million from the Scottish Government. It is envisaged that between £19 - £23 million of brokerage funding will be required in the current year. Management is in discussions with the Scottish Government to secure this funding and the delivery of the Quality and Sustainability plan.
- Management's underlying financial plan for 2018/19 and medium term financial strategy is predicated on continued brokerage support from the Scottish Government in 2018/19 and 2019/20. Without this funding, the organisation will exceed its resource allocation and report deficit positions.
- In concluding on the going concern basis, we have assumed that Scottish Government will continue to provide support to ensure the safe delivery of healthcare provision within the Highlands either through further financial brokerage or through permission for significant and radical service redesign.

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# Financial management



Whilst NHS Highland met its financial reporting targets, this was only achieved through in year brokerage of £15 million from the Scottish Government. This reflects the underlying operating model being increasingly financially unsustainable.

We note that in-year the Board still achieved savings of circa £35million in year. However, only £10million of these savings were considered recurring in nature and has further added to the financial challenges facing the Board.



From early 2017/18, NHS Highland was forecasting deficits against resource allocations. This was primarily due to the challenge in identifying and delivering £15 million of unidentified savings required for the year as well as in year cost pressures.

In October 2017, the Board began discussions with the Scottish Government around requirement for financial brokerage although this was not formally agreed until March 2018. There continues to be significant volatility across the forecast outturn throughout the year. While we recognise the volatility in cost base due to demand lead services, the Board started the year with £15 million of unidentified savings and therefore was always under pressure not only to achieve challenging targeted savings but identify, and deliver further savings in year.



The Board's underlying financial position is increasingly unsustainable. The Board overspent across service areas including adult social care of £6.2 million and clinical services overspent by £3.2 million due to increased demand and cost of care pressures. In addition, cost pressures lead to an overspend on drugs and prescribing of £3.2 million.

Lastly, like other rural NHS Board's sustainability of workforce is a pressure, and in particular clinical costs to sustain a suitable level of care increased in year reflecting additional consultant payments; and the cost of agency and locums.

During our audit planning process, we identified a risk around the financial management arrangements in place at the Board given the significant financial challenges faced.

We have undertaken procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial management arrangements. This included review of financial plans and performance reports.

#### Identified audit risk at planning

The Health Board achieved its financial targets in 2016/17. However, this was achieved through non-recurring savings of £6 million and a one-off approved transfer of capital to revenue funding of £2.5 million. With the level of savings required in 2017/18 being even more challenging than previous years, it is essential that robust financial management arrangements are in place to ensure that it can continue to meet patients needs.

**Our Response:** We reviewed NHS Highland's financial management arrangements informed through the work of internal audit and the high level financial framework of policies and procedures. This included financial planning and monitoring arrangements in place.

#### Conclusion

NHS Highland reported a saving against the Revenue Resource Allocation of £0.477 million. However, the outturn position was only achieved through the receipt of additional £15 million of financial brokerage from the Scottish Government. Without this funding, NHS Highland would have reported a deficit of £14.523 million.

For 2017/18 the Board identified that £48 million of efficiency savings were required in order to break even in year. Additionally, during the year, cost pressures of £1.5 million, primarily through adult social care operating costs and cost of drugs in short supply led to an increase in required savings. This was a significant increase from the £28.8 million in 2016/17.

The Board achieved £35 million of savings, of which £10 million were delivered on a recurring basis. While this represented delivery of unprecedented level of savings for the Board it was still significantly short of the required level.

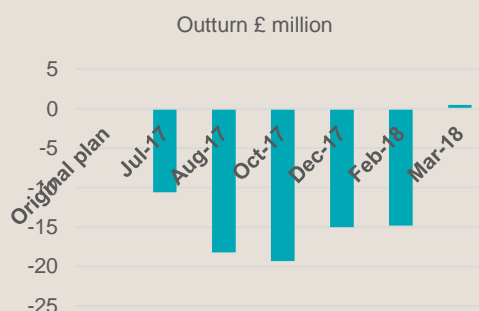
	Resource £ million	Expenditure £ million	Saving / (Excess) £ million
Core	693.631	693.154	0.477
Non-core	28.202	28.202	0
<b>Total</b>	<b>721.833</b>	<b>721.356</b>	<b>0.477</b>

#### Financial planning and monitoring

Financial performance is reported through to the Board and NHS Highland is subject to close financial monitoring by the Scottish Government who receives financial performance information a monthly basis, the Board's underlying financial position

The draft financial plan for 2017/18 was originally presented at the Board development Day in March 2017 and included within the Quality and Sustainability Plan. From the outset, management recognised that approximately £15 million of the required £48 million of savings were not yet identified.

Throughout the year the Board's forecast outturn position significantly deteriorated. This reflected the failure to deliver the levels of savings required to balance the financial position.



#### Ability to deliver savings

The outturn position for the year reflects a combination of overspends across services and failure to deliver planned savings in the year. Financial pressures included costs in delivering adult social care services through increased demand and inflationary pressures. Furthermore, the disperse nature of the population served creates challenges in delivering savings through streamlining of services. **Action Plan 1.**



- Underdelivered savings (£12.7m)
- Service overspends (1.8m)

## Delivery of outturn performance

The underlying financial outturn position reflects some of the unique challenges that NHS Highland faces.

For underlying pay costs, the Board were underspent by £1.1 million against budget. This reflects the level of unfilled vacancies NHS Highland has. In December 2017, 4.86% of the WTE vacancies were unfilled, primarily through the inability to attract and retain skilled and experienced staff.

However this is offset by the Board overspending on medical areas by £3.6 million, primarily through the use of locums due to the remote care services like Caithness. This is evidenced in the remuneration report, where the number of clinicians earning over £200,000 per annum has increased with a number of clinicians earning circa £400,000 per annum, which has significantly moved the median pay calculation in year.

Key non-pay cost pressures were:

- relating to social care with an overspend of £6.2 million relating to higher volumes / cost of care;
- clinical services with an overspend of £3.2 million;
- drug costs (hospitals and prescribing) were overspent by £3.2 million.

Whilst there were some small underspends across non-pay costs, the net overspend was £11.8 million. This was partly offset through higher than forecast income of £4 million than budget and operational slippage of £5 million through not incurring programme expenditure. This includes slippage on expenditure of £4.2 million. While we recognise that due to late allocations there can be an element of the RRL allocation that remains unspent at the year end and consequently is an unfunded commitment in the next financial year. Due to the nature of RRL allocations being received throughout the year, including towards the end of the financial year, there can be instances where RRL allocation is received relating to support for a programme of work that is not yet completed. This creates additional financial pressure in 2018/19 where the expenditure will be incurred without the resource allocation to support it.

## Capital expenditure

NHS Highland reported a breakeven position against its capital resource limit of £21.936 million. The most significant areas of investment related to Raigmore theatres and critical care. The level of expenditure was slightly below the original planned level of expenditure of £26.6 million.

Through review of minutes and the capital programme, we have observed that NHS Highland manage capital investment in line with available funding. Furthermore, the Capital Plan includes some strategic programmes that are subject to discussions with the Scottish Government for additional capital support such as e-Health, where the final capital investment received was less than planned.

We are satisfied that capital programme continues to be closely monitored by the Board and investments controlled to within available finance.

Area	Under / (Over) spend £ million
Pay underspend	1.1
Non-payroll related operational expenditure	(11.8)
Operational slippage	5
Additional operational income and offsetting benefits	4
Undelivered savings	(12.7)
Brokerage	15
<b>Outturn</b>	<b>0.5</b>

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# Financial sustainability



NHS Highland's underlying operating model is not financially sustainable without significant changes to service delivery and potentially provision. Over £50 million of savings are required for 2018/19. The Board is unlikely to achieve this without impacting on patient care unless it secures financial brokerage from Scottish Government and longer term workforce and wider service redesign.



Management are taking both a strategic and operational approach to addressing the financial position. The Quality and Sustainability Plan is looking at fundamental changes to service delivery to deliver a sustainable operating model over the medium term.

While a number of indicators are nationally set targets, potentially, given the context of a challenging financial environment, NHS Highland may need to revise their quality benchmarks to align to available workforce and money and with different models of care.



NHS Highland is going through a critical period requiring strong leadership, capable of making difficult decisions and delivering and embedding change.

Cost pressures through pay and non-pay inflation as well as increasing levels of service demand, particularly across adult social care mean the organisation cannot stand still. Likewise, the disperse nature of the territory creates additional challenges in developing an efficient, effective operating model.



NHS Highland operate a lead agency model with Highland Council for Adult Social Care. One area of overspend and continued cost pressures is related to North Highland Adult Social Care services. Whilst there is starting to be evidence of improved outcomes through the lead agency model, the way the lead agency model was established, and the underlying agency agreement the risks all rest with NHS Highland. Any increase in demand or increasing costs are required to be met by the Health Board, as the Council contribute a pool of money and do not meet additional pressures.

Within our audit plan we identified risk around financial sustainability at NHS Highland. In accordance with the Code of Audit Practice, we have undertaken appropriate procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial sustainability. This includes review of corporate and financial strategies and plans as well as discussion with senior management.

Identified audit risk at planning

NHS Highland continues to face significant financial and operational challenges. The LDP identified that savings of £47million were required for 2017/18 and approximately £100 million over the next three years. This reflects demand lead pressures including prescriptions and staffing costs. Furthermore, the uncertainty around the potential impact of Brexit on future finances and workforce creates additional challenges.

Management recognise that significant transformational change is critical to the financial sustainability of the board.

**Our Response:** We discussed financial sustainability with NHS Highland Management. We reviewed the financial plans in place, including the scenarios set out, the governance of the plans and regular reporting on future financial scenarios.

Conclusion

NHS Highland face significant financial challenges during 2018/19 and beyond. While NHS Highland has enjoyed relative protection from funding reductions across the wider public sector, with a forecast baseline uplift of 1.5% in 2018/19 plus a further £3.1 million of NRAC (NHS Scotland Resource Allocation Committee, basis of allocating funding) parity funding, the Board has forecast that it will need to deliver savings of £50.7 million in 2018/19.

The level of savings required is primarily due to a combination of factors:

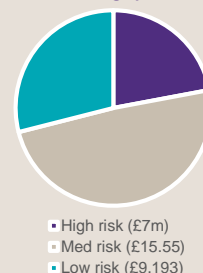
- Over £21 million being cost and service pressures, driven through demand in care, particularly around adult social care, as well as ensuring sufficient resource to deliver waiting times targets
- Inflationary pressures, including drugs and staff costs. These cumulatively have been estimated around £25 million
- There is also a recurring carry forward of £29 million, reflecting the reliance on non-recurring savings in 2017/18 and failure to deliver required outturn position.

The residual gap of £50.7 million is a significant challenge. Management have initiated two main approaches to achieve financial balance for 2018/19: A strategic approach through the Highland Quality and sustainability Plan, looking at the delivery of a sustainable operating model over a three year period; and through targeted in year savings.

The Quality and Sustainability Plan acknowledges that the Board can no continue to operate under the existing operating model. Progress has been made during the year across a range of work streams and a one year update was reported to the March 2018.

For 2018/19 work is underway through a services of work streams to identify areas of saving. In total £31.7 million of savings have been identified, including £7.7 million through service redesign and £7 million from adult social care. Of these savings, there is still a significant degree of risk and uncertainty around delivery. Furthermore, these remain short by £19 million of the required £50.7 million.

Risk Profile Savings plans £ million



The Board is unlikely to be able to meet its financial targets over the next two years without substantial additional brokerage funding from the Scottish Government. The Board has requested brokerage support of between £19 million and £23 million for 2018/19. We have concerns around the Boards financial sustainability. Delivery of the required savings will be a significant challenge particularly in an operating environment where the organisation is exposed to demand led cost pressures. Given the magnitude of the financial savings required, fundamental changes in service provision are likely to be required. The critical challenge for the Board is delivering required efficiencies without adversely impacting on quality of patient care. Furthermore, securing political and public buy in to significant changes to services will be a considerable challenge. **Action plan 2**

## Financial capacity and capability

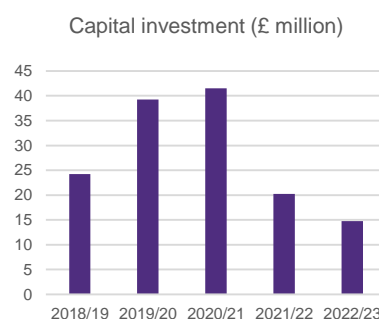
In July 2017, the Director of Finance left the organisation. Given the financial challenges facing the organisation it is key that they have strong strategic leadership, particularly from financial strategy, delivery and governance perspective. The position of Director of Finance, or equivalent, plays a key role in this. Currently, the Board have an interim arrangement in place to fill the Director of Finance. We recognise that the Interim Director of Finance has stepped in to the role, identifying early in the current year the need for financial brokerage support and has been working with the Scottish Government to develop a strategy for delivering a financial sustainable organisation. However, given the magnitude of the challenges facing NHS Highland, it is critical that they have the certainty of a permanent solution to drive forward the financial strategy for the organisation. It is acknowledged this may rest on decisions around the North of Scotland Regional plan but this is only one option, and there is yet to be certainty.

## Capital planning

In March, NHS Highland approved a five year capital plan. The plan has been developed in the context of the Regional Asset Management Plan due for presentation at the Board in July 2018. The Capital plan aligns to the Board's strategic priorities, but reflects the constraints on the level of funding available.

The plan includes contingency of between £0.7 million and £1.8 million each year and includes ongoing programmes. The most significant areas of expenditure include £31 million of investment in Skye and Badenoch & Strathspey, and £29 million of investment in the elective care centre.

The Health Board has identified areas that strategically it would look to invest in to support the delivery of strategic priorities and is subject to ongoing discussion with Scottish Government around obtaining capital funding to support these.



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# Governance and transparency



During 2017/18, the Board has continued to look to develop the governance arrangements in place. Six new non-executive members took up positions on the Board during 2017/18.

A new Finance Sub-Committee was established in late 2017, to enhance scrutiny and monitoring of financial performance, which has led to increased scrutiny over the financial plans.



NHS Highland, in consultation with the Scottish Government commissioned a review of governance arrangements at the Board. The report is due to formally conclude late Summer 2018. The Board has attempted to enhance governance arrangements, particularly around the lead agency model for adult social care. However, this becomes complex and there are opportunities to continue to enhance the governance arrangements in place during 2018/19.

There continues to be a significant turnover in non-executive members and as a result a challenge in ensuring members have the skills, experience and training to support the organisation. Furthermore, stability across leadership is important to set a clear tone from the top, and consequently the culture and performance of the organisation.



NHS Highland is looking to further develop partnership working arrangements. This includes arrangements with Highland and Argyll and Bute council's in respect of Health and Social Care alongside working with the North of Scotland NHS Territorial Boards as set out in the draft North Regional partnership plan.

Given the significant challenges NHS Highland faces, it is essentially that opportunities for driving efficiencies and improvements in service performance through joined up working are continued to be explored.



Within our audit plan we identified risk around governance and transparency at NHS Highland. In accordance with the Code of Audit Practice, we have undertaken appropriate procedures to allow us to form a conclusion around the identified areas of risk and the organisation's governance arrangements. This includes review of governance structures and committee and Board minutes.

#### Identified audit risk at planning

NHS Highland Board and officers are responsible for establishing robust governance arrangements. During 2016 the board commissioned an independent review of governance arrangements which identified a number of recommendation including enhancing the leadership and scrutiny role of the Board.

During 2017 we identified opportunities for the Board to strengthen its governance arrangements including filling the vacant Non-Executive posts.

**Our Response:** As part of our overall assessment of governance, considered the progress made by NHS Highland in implementing agreed actions to enhance governance arrangements. This includes effective scrutiny and challenge of financial and non-financial performance.

#### Conclusion

NHS Highland continue to enhance their governance arrangements. During 2017/18 there was a significant change in the membership of the Board including six new non-executives joining the Board.

The Board has an established governance framework in place. This includes ensuring that the Board's key objectives and planned outcomes for the year, as set out in the annual operational plan, are subject to regular monitoring through the board but also the Highland Health and Social Care Committee and Argyll and Bute integration Joint Board to provide assurance that operational units performance is being tracked.

During 2017/18, the Board established the Finance Sub-Committee. In the context of significant financial challenges, this committee will play an important role of ensuring focused scrutiny and challenge of financial performance and delivery.

From attendance at Audit Committee meetings and from review of Board and committee minutes and papers we have observed that there are still opportunities to develop and enhance governance arrangements. In particular:

- Ensuring that there is appropriate attendance at committees
- While acknowledging operational challenges, ensuring the Board focus on strategic priorities and direction.
- Ensuring that internal audit recommendations are addressed in a timely manner or closed if no longer considered of strategic importance or best use of resources.

The Chair of the Board, in consultation with the Scottish Government, commissioned a review of the Board's Governance arrangements and this is due to report in late summer 2018. The Board should ensure that it considers the findings from the review and implements any required changes to enhance its governance arrangements during 2018/19 and the action plan is collectively owned by the Board and Senior Management Team.

### Risk management

NHS Highland has reasonable arrangements for the identification and management of key strategic risks facing the organisation. NHS Highland has in place a risk management framework in place for the identification, management and scrutiny of risks. In March 2017, the Board approved a paper on 'Risk Appetite' which aimed at providing clarity by articulating the Board's appetite for risk exposure and management across various types of risk. The Risk Management Steering Group, chaired by the Chief Executive, meets quarterly to scrutinise strategic risks.

NHS Highland continue to look to enhance risk management. In December 2017, more formal reporting risk reports were introduced to Audit Committee meetings to allow greater scrutiny of risks and alignment between risks and NHS Highland's strategic priorities. We will continue to monitor how these arrangements embed.



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## Fraud and Irregularity

NHS Highland has arrangements in place to help prevent, detect and mitigate the risk of fraud or irregularity, including anti-bribery and whistleblowing policies. While we consider these to be reasonable, no arrangements can fully prevent against the risk of fraud, theft or irregularity. We are not aware of any material frauds at NHS Highland during the course of the year and have confirmed this with management.

The Board participates in the National Fraud Initiative (NFI), 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 exercise during 2017/18 to be satisfactory. The Board has effective arrangements in place for the submission of data and investigation of potential matches.

## Internal Audit

As set out in our external audit plan we have not placed formal reliance on the work of Scott-Moncrieff, the internal audit provider, during 2017/18. We are satisfied that internal audit findings, including the annual audit opinion, has been considered by the Accountable Officer when concluding on the annual Governance Statement. We note that as at December 2017 there were over 100 outstanding internal audit recommendations. It is critical that management address control deficiencies or gaps identified by Internal Audit where these represent a significant risk to the organisation. Management should look to assess whether any outstanding recommendations have been superseded or are not considered a significant risk and therefore no longer an area of priority for the Board, and this should be formally recorded and approach approved by the Audit Committee. **Action Plan – 3.**

## Transparency

Board minutes and supporting papers are published online as well as a range of corporate publications detailing the Board's underlying performance and activities. There are however opportunities to enhance public reporting with more transparent reporting of underlying performance information on the NHS Highland website. Furthermore, while NHS Highland has an established process for managing and responding to Freedom of Information (FOI) requests, our external review of certain primary/secondary care procurement and contract performance monitoring identified that improvements were required on the manner in which the Board responds to FOI requests to ensure they promote openness and transparency and actively promote engagement with service users/stakeholders. We will follow up this action during our 2018/19 audit work.



## Partnership Arrangement



During 2018, the Board and Highland Council undertook a review of partnership arrangements between NHS Highland and the Council. The focus was to allow greater integration between the Council and NHS Highland reflecting a backdrop of increasing demand pressures and financial challenges. The new arrangements seek to promote greater joined up working through Joint Officers working groups with oversight from the Highland Health & Social Care Committee and Adult Services Scrutiny & Development Sub Committee of the Council to allow greater joined up strategic planning for integrated adult social services. The Lead Agency model is an area of significant financial and operational challenge for the Board. NHS Highland are ultimately responsible for the risks in respect of financial sustainability and the ongoing delivery of adult social services in region.

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# Value for money



In the context of significant financial pressures, service delivery and performance will come under increasing pressure.

The Quality and Sustainability Plan aims at redesigning services to provide a sustainable service delivery while protecting the quality of patient care. Over a period of significant change it is increasingly important that performance is subject to robust, efficient and effective scrutiny.



Following concerns being raised around certain primary/secondary care procurement and contract performance management, we undertook an independent review of these on behalf of Audit Scotland.

Our report, published in December 2017, made key recommendations around enhancing these arrangements. We have considered the progress made by management to date in addressing issues raised and we will formally follow up on the recommendations in 2018/19 to ensure that these arrangements have embedded within the organisation. Overall we note regular progress updates to the Audit Committee related to this action plan, which set our good progress in implementing recommendations.

During our audit planning we did not identify any significant risks in relation to NHS Highland's arrangements for effectively utilising its resources and improving services. During our audit we considered the Board's arrangements for securing value for money on conclude on these below.

## Performance

There are two 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. Performance information covers both Local Delivery Plan standards as well as local measures to track performance. Performance reports have been refined throughout the year to enhance the understanding and transparency of reporting.

The latest LDP performance information was reported to the March 2018 Board and summarised below:

Area and number of targets	Number of targets met in 2017/18*	Number of targets met in 2016/17**	Trend
Health Improvement (4)	2	2	
Efficiency (4)	1	2	
Access to services (14)	3	5	
Treatment (3)	2	0	
<b>Total</b>		<b>9</b>	

\*Based on first three quarters.

\*\* Note measures have moved year on year therefore not a like for like comparison

There were a number of areas where the Board's performance fell below target and actions plans are in place to address these although it is acknowledge that in a number of areas service redesign is required in order to enhance performance to meet the desired target levels. In the context of significant financial pressures, service delivery and performance will come under pressure. The Quality and Sustainability Plan aims at redesigning services to provide a sustainable service delivery while protecting the quality of patient care. Over a period of significant change it is increasingly important that performance is subject to robust, efficient and effective scrutiny.

### External review of certain primary/secondary care procurement and contract performance monitoring

In December 2017, following concerns around NHS Highland's contract management and procurement arrangements, we undertook a review on behalf of Audit Scotland of certain primary / secondary care procurement and subsequent contract performance monitoring arrangements. Our review was reported to NHS Highland in December 2017 and identified a number of actions necessary for management to strengthen the procurement and subsequent performance contract monitoring arrangements in place at the Board. Management have accepted the findings from our review and we have considered the progress to date in addressing the issues identified. We will formally follow up on these actions as part of up 2018/19 review to ensure actions taken have embedded within the organisation.

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# Appendices

**Audit adjustments**

**Action plan and follow up of 2016/17 recommendations**

**Fees, independence and fraud arrangements**

**Communication of audit matters**

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# Audit adjustments

## **Uncorrected and corrected misstatements**

We are pleased to report that there were no uncorrected misstatements to the financial statements arising during our audit. There were minor misstatements identified around property, plant and equipment but these were wholly immaterial and below our trivial threshold.

## **Disclosure misstatements**

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

There were no material/significant disclosure misstatements identified we wish to bring to your attention. Minor changes included enhancing disclosures within the financial statements including the performance and accountability reports.

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# Action plan and follow up of 2016/17 recommendations

We have set out below, based on our audit work undertaken in 2017/18, those risks and recommendations we consider are of a higher risk to NHS Highland that Management may wish to consider in the future. We have also completed follow up of our 2016/17 recommendations and this is reflected below for information.

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## Recommendation

## Agreed management response

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### Financial management

Excluding brokerage received in March 2018, NHS Highland's underlying financial performance was a £14.5 million overspend against revenue resource allocations. The financial budget for 2017/18 had unidentified savings of £15 million. In addition, throughout the course of the year management struggled to contain service overspends, particularly across adult social care and the costs of drugs. The budget for 2018/19, also has unidentified savings of over £19 million. While we recognise that additional oversight and scrutiny has been put in place during the year, including the establishment of the Finance Sub-Committee, we have significant concerns over the ability of the Board to not only deliver the identified savings and manage in year financial cost pressures, but also being able to identify and deliver these unidentified savings. Management have sought financial brokerage from the Scottish Government and it is critical that the Board seek confirmation from the Government around any additional support required.

### Management response:

NHS Highland is committed to a 3 year plan to bring the Board's financial position back into recurrent balance by the end of financial year 2020-21.

It is expected that the Board will overspend in each financial year leading to recurrent balance in 2020-21 and discussions are progressing with Scottish Government officials to agree the principles and financial impact of the 3 year Quality and Sustainability Plan.

**Action owner:** Director of Finance

**Timescale for implementation:**

2018-19 to 2020-21

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### Financial sustainability and performance

Given forecast financial pressures, the Board has requested brokerage support of between £19 million and £23 million for 2018/19. We have concerns around the Board's financial sustainability. Delivery of the required savings will be a significant challenge particularly in an operating environment where the organisation is exposed to demand led cost pressures. Given the magnitude of the financial savings required by the Board, fundamental changes in service provision are likely to be required. The critical challenge for the Board is delivering these without adversely impacting on quality of patient care. Underpinning this is the need for clear and transparent financial and non-financial performance reporting, focused on the Board's key indicators. During periods of significant service redesign and change it is critical that the Board focuses on key strategic outcomes and has meaningful, timely performance information to support decision making process.

### Management response:

NHS Highland recognises the significant in 2018-19 to deliver savings and manage cost pressures.

The Board's Finance Committee and the Finance & Performance Sub-Committees of the Integration Authorities have a key role in monitoring both service performance and financial performance.

The development of these two committees will provide a locus for additional scrutiny of financial performance, providing assurance for the Board that both financial and non financial performance are robustly reviewed.

**Action owner:** Director of Finance

**Timescale for implementation:**

2018-19

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# Action plan and follow up of 2016/17 recommendations

## Recommendation

## Agreed management response

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### Internal audit recommendations

It is critical that management address control deficiencies or gaps identified by Internal Audit where these represent a significant risk to the organisation in a timely and proportionate manner.

We recommend that Management review the outstanding recommendation and ensure that there is clear ownership and accountability around the implementation of these. This may require reassessment of agreed actions and implementation dates to ensure these are deliverable and appropriate. Management may look assess whether any outstanding recommendations have been superseded or are not considered a significant risk and therefore an area of priority for the Board.

**Management response:** A review of all outstanding recommendations will be undertaken during 2018/19

**Action owner:** Director of Finance

**Timescale for implementation:** October 2018

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## Follow up of 2016/17 External Audit Recommendations

Action as at May 2018

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### 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.

### Ongoing

Management have reviewed the performance report and ensured that applicable disclosures have been made. The current report aligns in year performance with a focus on outlook. There are still opportunities to continue to develop the reporting by potentially including a overall summary of non-financial performance rather than just referencing external documents.

**Management response:** We will review disclosure requirements

**Action Owner** – Director of Finance

**Updated timescale for implementation:** 18/19 Annual Accounts

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### 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 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.

### Outstanding

Whilst the Board did deliver significant savings in the year, for 2017/18 £15 million of brokerage funding was required to meet it financial targets. This reflected undelivered savings as well as additional in year pressures. For 2018/19, over £19 million of savings remain unidentified. We recognise that management are taking a more strategic approach to addressing the financial challenges but delivery of these remains a significant risk.

### Management response:

NHS Highland continues to undertake regular discussions with Scottish Government officials regarding the Board's forecast financial position for 2018-19 as well as the principles and financial impacts of the three year quality and sustainability plan

**Action owner:** Chief Executive & Director of Finance

**Updated timescale for implementation:** 2018-19

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### 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

### Completed

Finance sub-committee established in year to help with financial scrutiny. Board reporting is comprehensive and it recognises the financial pressures facing the Board.

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### 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 saving plans.

### Complete

The Board currently has an interim Director of Finance in place. Given the financial pressures facing the Board it is essential that there is clear strategic financial leadership in place.

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## Follow up of 2016/17 External Audit Recommendations

## Action as at May 2018

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### Audit Committee Training

Following changes to the Audit Committee membership, provide refresher training during 2017/18.

### Outstanding

Ongoing member training and development process in place through ongoing appraisal and the board are implementing development sessions with members which reflect the needs of non-executives. However, given the turnover in non-executive members this remains a key area.

**Management response:** Ongoing review with skills matrix being developed to support non-execs training

**Action owner:** Board Secretary

**Updated timescale for implementation:** Autumn 2018

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### 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.

### Ongoing

The Board have enhanced governance arrangements throughout the year. However there are still opportunities to enhance these arrangements. The Board, in conjunction with the Scottish Government, have undertaken a governance review. It is expected that the review will conclude in autumn 2018 and management will implement any required changes emerging from this.

**Management response:** Board to review governance arrangements

**Action owner:** CEO

**Updated timescale for implementation:** Autumn 2018

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### 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.

### Complete

NHS Highland use a combination of Scottish Government key performance indicators as well as local performance indicators. Performance is monitored across both Argyll & Bute Integrated Joint Board and Highland Health and Social Care Committee as well as an overarching balanced scorecard for NHS Highland. This includes delayed discharges.

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### 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

### Complete

Governance handbook has been updated

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### 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

### Complete

Website contains most recent approved papers

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# Fees, independence, fraud arrangements

## External Audit Fee

Service	Fees £
External Auditor Remuneration	141,600
Pooled Costs	20,460
Contribution to Audit Scotland costs	8,540
Contribution to Performance Audit and Best Value	0
<b>2017-18 Fee</b>	<b>170,600</b>

The audit fee was calculated in accordance with guidance issued by Audit Scotland and agreed with Management.

The above fee has not changed and our final fee was £170,600.

We also received additional remuneration directly from Audit Scotland in relation to our certain primary/secondary care procurement and contract performance monitoring. This fee was circa £6,000.

## Fees for other services

Service	Fees £
We can confirm there are no non-audit fees for the 2017/18 financial year	Nil

## Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.

We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.

We can confirm no independence concerns have been identified.

## Fraud arrangements

In assessing our audit risks, the audit team was alert to the possibility of fraud at NHS Highland.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relation to management override of controls.
- Leading a discussion with those charged of governance (for NHS Highland this is assumed to be the Audit Committee) on their view of fraud. We did this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit. – None were identified in-year

As auditors we obtain reasonable but not absolute assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

It is **NHS Highland's** responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we worked with NHS Highland to review specific areas of fraud risk, including the operation of key financial controls.

We also examined certain policies in place, strategies, standing orders and financial instructions, as relevant to the fraud framework, to ensure that they provide a reasonable framework of internal control.

No suspected frauds or irregularities have been identified by Management and reported in-year.

# Communication of audit matters to those charged with governance (the Board)

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity	•	•
<b>We are independent of NHS Highland and have not identified any conflicts of interest</b>		
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
<b>We have not incurred any non-audit fees during the year and no threats to independence identified</b>		
Significant matters in relation to going concern	•	•
<b>No significant going concern matters identified although we have identified significant financial pressures which are referenced in our report.</b>		
Views about the qualitative aspects of NHS Highland accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
<b>Set out in the Financial statements Section</b>		
Significant findings from the audit		•
<b>No significant findings from our audit</b>		
Significant matters and issues arising during the audit and written representations that have been sought		•
<b>Letter of representation will be shared and signed by the Accountable Officer when signing the financial statements. This is our standard, unmodified letter of representation.</b>		
Significant difficulties encountered during the audit		•
<b>No difficulties encountered</b>		
Significant deficiencies in internal control identified during the audit		•
<b>None identified</b>		
Significant matters arising in connection with related parties		•
<b>None identified</b>		
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
<b>None identified. A nil fraud return was submitted to Audit Scotland in April 2018 in accordance with the planning guidance.</b>		
Non-compliance with laws and regulations		•
<b>None noted</b>		
Unadjusted misstatements and material disclosure omissions		•
<b>None noted. Minor disclosure amendments only and these were not material in nature</b>		
Expected modifications to the auditor's report, or emphasis of matter		•
<b>None, an unqualified opinion</b>		

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table above.

We communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to NHS Highland Management and the Audit Committee.

