

Financial Review

- The Board achieved both of their financial performance targets (see 2.1)
- The Board have prepared a balanced budget for 2006/07 following a rigorous review of developments and risks (see 2.4)

Financial Statements

- Our opinion on the financial statements is qualified in respect of two issues
 - the accounting treatment of the Easter Ross Resource Centre (see 3.1)
 - the accounting treatment of the finance lease payments in respect of the New Craigs facility (see 3.1)
- Our opinion on regularity is unqualified (see 3.3)

Corporate Governance

- Our opinion on the Statement of Internal Control is unqualified (see 4.1)
- The “Priorities and Risks Framework” audit planning tool was used again this year. A summary of our “position statement” report is at 4.3.

Performance Audit

- a high level review of Best Value arrangements was completed in the year.
- management arrangements in respect of “Efficient Government” were assessed.

Action Plan

Four recommendations are made:-

- The Board should continue to monitor the achievement of the recurrent savings plan.
- The Board should continue to progress towards a refined financial planning process.
- The Board should ensure that risks identified from the PRF process are reflected in the Risk Register.
- The Board should ensure that robust arrangements are in place to demonstrate that Efficient Government savings targets have been met.

Acknowledgement

We take this opportunity to thank the Board Members and staff of the Board for assisting and co-operating with us during the course of our appointment.

We also thank the Audit Committee for assisting in the completion of the Action Plan.

The purpose of the financial review is to consider the general financial standing of the Board by looking back at financial performance in 2005/06 and to look ahead to the future financial position. Our review is aimed at helping Board members understand the financial position of the Board at a particular point in time. It should not be regarded as definitive or comprehensive and the Board should not seek to rely on this summary in isolation.

Contents:

- **Financial Objectives 2005/06**
- **Performance against budget 2005/06**
- **Underlying Financial position 2005/06**
- **Financial Plan 2006/07**

2.1 Financial Objectives 2005/06

The Board is required to stay within two financial performance targets:

- the Revenue Resource Limit (RRL)
- the Capital Resource Limit (CRL)

The RRL is the total funding in-year which has been allocated by the Scottish Executive for patient services. The CRL applies to in-year capital expenditure, and is set by the Scottish Executive.

The Cash Requirement is a financing requirement to fund the cash consequences of the ongoing operations and the new capital investment. The Board is required to remain within its cash requirement, but this is considered to be a budget level rather than a financial target.

The table below summarises the Board's performance and shows that the Board achieved the two financial targets, and the cash requirement target.

	Target £'000	Outturn £'000	Achievement
To remain within the RRL	330,747	329,738	Yes
To remain within the CRL	11,900	11,794	Yes
To remain within the Cash Requirement	341,345	341,345	Yes

2.1 Financial Objectives 2005/06 (cont'd)

Revenue Resource Limit (RRL)

The Board is aware that the above was achieved with the use of significant non-recurring resources (see the table at 2.3).

Capital Resource Limit

The Capital Resource Limit, as originally advised by the Scottish Executive, was £14.173m. This included £3.3m which had been unused last year and carried forward to this year's allocation. Of this the Board sought and received approval to transfer £3.2m to support the revenue resource limit. After the year-end approval for a further transfer of £1m was received.

In November 2005, the Asset Management Group agreed that schemes totalling £2.35m, which had originally been planned for 2005/06, should be carried forward to 2006/07. At that time an equivalent amount (£2.35m) of the allocation was returned to the SEHD to be carried forward to next year to fund those schemes. However, of this, £2m has been subsequently drawn down, partly to support the additional transfers to the revenue allocation. Clearly this means that there is a risk that in 2006/07 sufficient funds will not be available to fulfil the Board's plans.

Cash Requirements

This target was met.

2.2 Performance against budget

The Board set a budget of £346m in April 2005.

This figure was amended during the year as further developments and actions were funded from SEHD, resulting in a "final" budget of £359m at March 2006.

The final expenditure to be set against the RRL is £329m (see 2.1). This is calculated as follows:

	Budget £m	Expenditure £m
Gross	359	360
Other Income	(16)	(16)
	-----	-----
Net	343	344
	=====	
Less: Non discretionary allocation		(14)
Less: Capital Grant		(1)

To be met from RRL		329
		=====

2.2 Performance against budget (cont'd)

This commendable performance was assisted by two unusual factors.

- transfers from Capital allocation of £4.2m.
- review of accounting treatment of expenditure budgeted as revenue to be reclassified as capital of £1m.

The ability to transfer resources from capital to revenue will cease with effect from 1 April 2006, further restricting the scope for flexibility in meeting funding gaps. This has been taken account of in the Board's financial plans.

2.3 Underlying Financial Position

One of the major challenges in managing the financial position of the Board is having the flexibility to adapt to different national and local initiatives. National initiatives, in particular, are often subject to specific funding ("ring-fenced") which is for a prescribed period.

Some areas of expenditure are effectively fully funded by the SEHD, based on the actual spend (referred to as "non-discretionary"). This primarily relates to elements of Family Health Service (FHS) expenditure. These are generally referred to as non-recurring, in the sense that they are not part of the core funding. For the purposes of the table opposite we have excluded this income and related expenditure (£14m).

Other projects with this type of funding can stretch over two or three financial years, and can occur on an annual basis.

The following table illustrates this by analysing the funding and expenditure for 2005/06.

2.3 Underlying Financial Position (cont'd)

Highland NHS Board	£m	£m
Recurring income	344.8	
Recurring expenditure	362.4	
Underlying recurring (deficit)		(17.6)
Non-recurring income	0.3	
Non-recurring expenditure	5.5	
Balance of non-recurring		(5.2)
Gap		(22.8)
Other income sources	-	
Non-recurring SEHD income/year-end support	16.2	
Corporate savings programme	8	
Total other income		24.2
Financial surplus for 2005/06		1.4

This illustrates that the Board faced a recurring funding gap of £17.6m, and only balanced the books from supplementary allocations from SEHD, and a savings programme.

2.4 Financial Plan 2006/07

The anticipated final resource limit revenue allocation for 2006/07 is £508m. This includes an allocation of £149m in respect of Argyll and Bute.

Budget proposals for 2006/07 were submitted to the Board in March 2006. This informed the Board of the initial revenue resource allocation and anticipated that there would be a breakeven position for 2005/06.

In this report, the Head of Financial Planning highlighted a number of financial pressures for 2006/07 including:-

- Pay uplift £4.9m
- Full year effect of agenda for change - £3.8m
- Prescribing and hospital drugs - £2.2m
- GMS Contract - £2.6m

The Head of Financial Planning, at that stage forecast a shortfall of approximately £16.3m.

£1m of this is expected to be met from an increased share of resource funding. This requires savings of £15.3m to be achieved in 2006/07 to balance the budget.

This does not take account of any potential deficit in respect of the newly acquired Argyll and Bute CHP. Because of the lack of a common data source, this element of the overall budget has been prepared separately, drawn from the previous Argyll and Clyde Board financial plan. This CHP budget allows for a £1.5m savings plan and forecasts a £1.5m deficit. Highland Health Board are in discussion with the SEHD regarding additional bridging funding to close this gap.

2.4 Financial Plan 2006/07 (cont'd)

The Head of Financial Planning highlights a number of risks associated with this CHP budget, including:

- no SLAs for support services currently in place for an estimated £10m of services from Greater Glasgow and Clyde Health Board (GGCHB)
- no supporting evidence for commissioning with GGCHB of £32.6m

The full budget for 2006/07, analysed between recurring and non-recurring funding and expenditure, is shown in the table overleaf.

2.4 Financial Plan 2006/07 (cont'd)

Highland NHS Board	£m	£m
Recurring income	505.2	
Recurring expenditure	522.1	
Underlying recurring (deficit)		(16.9)
Non-recurring income	2.1	
Non-recurring expenditure	3.6	
Balance of non-recurring	(1.5)	
Gap		(18.4)
Other income sources		
Non-recurring SEHD income/year-end support	1.6	
Corporate savings programme	16.8	
Total other income		18.4
Projected financial surplus/(deficit) for 2006/07		Nil

2.4 Financial Plan 2006/07 (cont'd)

The Board's reliance on non-recurring funding was highlighted to the Board by the Head of Financial Planning in April 2005. Work to develop a revised financial planning model, which seeks to address this issue, is planned but has still to be completed.

The Board have outline plans to achieve recurring savings of £12.4m over a three year period. (£2m in 2006/07; £5m in 2007/08; £5.4m in 2008/09). This is seen as a pragmatic interim solution to achieve recurring balance pending a complete overhaul of the financial planning process.

Recommendations

- the Board should continue to monitor the achievement of the recurrent savings plan.
- the Board should continue to progress towards a refined financial planning process.

The respective responsibilities of the Board, and Tenon Audit Limited are summarised in Appendix 3. The purpose of this section of our report is to highlight and explain our formal opinion on the financial statements, and to comment on the main issues arising from our audit of the financial statements.

Contents:

- **Audit Opinion**
- **Timetable and Procedures**
- **Regularity Opinion**
- **Issues for this year**
 - **Agenda for Change**
 - **Medical and Clinical Negligence**
 - **Termination payment provision**

3.1 Audit Opinion

We have issued a qualified audit opinion and report on the accounts of Highland Health Board for the year ended 31 March 2006.

A copy of our audit report is attached to this report as Appendix I.

Primary Care Centre at Easter Ross

We qualified our audit opinion last year in respect of the accounting treatment of the Primary Care centre at Easter Ross. As we reported in our annual report last year, the Board have taken the view that this transaction should be accounted for as an operating lease on the basis that substantially all the risks and rewards of ownership reside with the PFI contractor who constructed the resource centre, and continues to provide building maintenance services. This accounting treatment decision was reached after an estimate of the value of the risks which the Board felt resided with the operator. As we highlighted last year, the single largest component of this was in respect of unavailability risk (ie the risk that there will be faults within the building, which could trigger a penalty due to non-availability of all or part of the facility). The Board were unable to provide sufficient evidence to support their estimate of how frequently this would occur and what the impact would be. Given this lack of supporting evidence we concluded that, on balance and in the interest of transparency, the arrangement should be accounted for as a finance lease which would require the property to be shown as an asset on the balance sheet of the Board, together with the related financial obligation.

Primary Care Centre at Easter Ross (cont'd)

The Board were not persuaded to adopt this accounting treatment and we therefore qualified our opinion.

Following discussions with the Board and the SEHD the Board have been unable to supply any further evidence to support their view. Accordingly the qualification continues.

Finance Lease Payments

In July 2000 the then Highland Primary NHS Trust took possession of a new mental health facility which had been constructed under a PFI agreement (New Craigs). After discussions with the then Director of Finance it was agreed that this should be accounted for as a finance lease (ie on balance sheet). This required the establishment of a notional finance lease representing the funding for the asset which was included in the accounts.

We discovered during our audit of the accounts of Highland Health Board for the year ended 31 March 2005 that the basis on which the payments under the finance lease agreement had been accounted for was not in accordance with financial reporting standards. The total of the finance lease payment requires to be split into an interest charge element and an element which reduces the outstanding debt. Financial Reporting Standards require that this split is calculated to provide for a constant rate of interest on the level of outstanding debt over the period of the finance (ie on an annuity basis). Highland Health Board have accounted for this split by simply dividing the total finance charge over the 25 year period resulting in an equal charge each year. Similarly the repayment element is also divided by 25, resulting in an equal repayment each year. This results in an undercharge to the operating cost statement of approximately £426,000 for the current year. However, the accumulated effect for the period up to 31 March 2006 is approximately £2.6m.

3.1 Audit Opinion (cont'd)

Finance Lease Payments (cont'd)

In 2004/05 we considered qualifying the opinion on the accounts but concluded that we would not do so and raised a recommendation in our management letter that the accounting treatment be corrected in 2005/06.

In considering the impact on the accounts for the year to 31 March 2006 we are now required to take account of international standards on auditing which require a slightly different approach to assessing materiality and the impact of uncorrected errors. After consideration of all of this we concluded that we should qualify our opinion on the accounts for the year to 31 March 2006.

3.2 Timetable and Procedures

The deadline for submission of audited accounts of the Board to the Scottish Executive Health Department (SEHD) is 30 June.

The first draft of the published accounts including all narrative statements, was received on 22 May 2006.

Our audit was substantially completed by 14 June. A series of weekly progress meetings were held with the Director of Finance, and other key finance staff, culminating in a final meeting on 15 June.

A copy of the final version of the summarisation spreadsheet was received by us on 27 June 2006.

The accounts were approved by the Audit Committee and NHS Board on 27 June. Our audit was formally concluded on 30 June, within the SEHD deadline.

3.3 Regularity Opinion

The Public Finance and Accountability (Scotland) Act 2000 requires us to give an opinion on the regularity of expenditure and receipts.

Auditors are now required to confirm that “in all material respects, expenditure and income shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers”.

To meet this requirement we need to:-

- Have a sufficient understanding of such laws, regulations and guidance as are applicable.
- Test compliance with such provisions.
- Review the audited body's arrangements for implementing new legislation or statutory requirements which may have significant financial consequences.
- Consider the applicability to the audited body of relevant national issues which may have financial consequences.
- Consider transactions that are unusual or a questionable legality and which may have significant financial implications.

3.3 Regularity Opinion (cont'd)

We discharge this responsibility by reviewing the Board's system for ensuring that guidance issued by Scottish Ministers is appropriately acted upon, and where necessary, amendments to Standing Orders, Financial Instructions and procedures are introduced. We were satisfied that this system was appropriate. We test for compliance against Standing Orders and Financial Instructions and procedures as part of our annual audit work.

Difficulties in respect of regularity have been experienced in the past, principally relating to Primary Care Income and Expenditure.

Guidance on verification of aspects of the new General Medical Services (GMS) contract was revised during the year and re-issued in October 2005. The Board followed this guidance in their practice visits. As a result we have issued an unqualified opinion on regularity.

3.4 Issues for this year

Agenda for Change

The new terms and conditions package for most NHS Scotland employees (known as 'Agenda for Change') was ratified by the Staff Council in November 2004. 'Agenda for Change' relates to all employees other than medical and dental practitioners and executive/senior managers covered by other arrangements.

The new terms and conditions began from 1 December 2004, with an effective date of 1 October 2004.

The process of introducing the new terms and conditions includes matching jobs into an appropriate placing on the new pay scale. In order to achieve this, a job description for the existing role has to be agreed and 'matched' into one of the new job profiles. This is a lengthy process and is still ongoing.

The target date for all staff to be matched and paid on the new scales has been revised by SEHD to December 2006.

The Board have estimated a cost of £6.1m for the period 1 October 2004 to 31 March 2006 and this figure is included in the accounts.

Medical and Clinical Negligence

From 1 April 2000, new financial risk sharing arrangements for clinical negligence awards and certain non-clinical risk categories came into operation – Clinical Negligence and other Risks (Non-Clinical) Indemnity Scheme (CNORIS). In essence, the financial risks are managed within a single pool, with separate arrangements for incidents occurring or reported from 1 April 2000, and for pre 1 April 2000 losses.

3.4 Issues for this year (cont'd)

Medical and Clinical Negligence (cont'd)

The provision in the accounts for Medical and Clinical Negligence claims has been reduced from £0.6m to £0.248m.

	2005/06 £m	2004/05 £m
Gross Provision	2.6	2.783
Recoverable from CNORIS	(2.356)	(2.183)
Net Provision	0.248	0.6

A contingent liability of £1.4m is disclosed in respect of claims lodged, which the Board consider requires no provision. (previous year £1.87m) This is in accordance with advice from the Central Legal Office.

Termination payment provision

Included in Provisions (note 18), is an amount of £285,000 in respect of the capitalised value of pension enhancements of a former employee of Argyll and Clyde Health Board. Included in creditors is an accrual of £54,000. This liability arose on the dissolution of the former Board, and falls to Highland Health Board as this individual was previously employed in the area which is being taken over.

Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. The respective responsibilities of Highland Health Board and Tenon Audit are summarised in Appendix 3.

This section of our report comments on the main aspects of our work, and highlights particular issues which arose.

Contents:

- **Statement of Directors' Responsibility in respect of Internal Control**
- **New Organisation**
- **Priorities and Risks Framework**
- **Primary Care Income and Expenditure**
- **Internal Audit**
- **Management Letters**
- **Other Governance responsibilities**

4.1 Statement of Directors' Responsibility in Respect of Internal Control

Scottish Executive Health Department requirements in respect of this statement require a comprehensive and structured annual review of internal controls. This requires the Board to:

- Acknowledge their responsibility for ensuring that an effective system of Internal Control is maintained and operated
- State the main components of the system of Internal Control
- Review the effectiveness of the system
- Detail action taken or proposals to correct weaknesses.

The overall system of internal control consists of the following components:

- Financial
- Operational
- Compliance
- Clinical Governance

This statement and guidance is based on the outcome of the Turnbull Report on Corporate Governance (Internal Control: Guidance for Directors on the Combined Code). The Turnbull Report states that a sound system of internal control *"depends on a thorough investigation on the nature and extent of the risks to which the company is exposed"*. It goes on to say that the purpose of internal control *"is to help manage and control risk, rather than to eliminate it"*.

4.1 Statement of Directors' Responsibility in Respect of Internal Control (cont'd)

Risk Assessment and Management has therefore become a critical element of planning, managing and control.

As auditors of the Board, our role is to review the statement for:

- Compliance with Scottish Executive Health Department directions (in HDL(2002)11) and the Code of Audit Practice
- Consistency with our findings from our normal audit work.

We are required to provide an opinion on the statement within our Audit Report.

Following discussion with the Director of Finance, we were able to issue an unqualified opinion, a copy of which is attached to this report in Appendix 1.

4.2 New Organisation

On 31 March 2004 the two Highland NHS Trusts were dissolved and integrated with Highland Health Board with effect from 1 April 2004. A single operating division was established entitled Direct Health Services. A Direct Health Services Committee was established and met during the year.

Beneath the Direct Health Services were three area Community Health Partnership (CHPs) and one Specialist Services Unit (SSU) centred on the Raigmore Hospital site.

A scheme of establishment for the CHPs was approved in December 2004 and CHPs became fully operational from 1 April 2005.

Argyll and Bute

NHS Argyll and Clyde Health Board was dissolved on 31 March 2006, with the responsibility for health services in the Argyll and Bute council area transferring to NHS Highland. The Board decided that this area would represent an additional CHP. A scheme of establishment for the Argyll and Bute CHP was submitted on 22 March 2006. Approval for this scheme of establishment is still awaited.

4.3 Priorities and Risks Framework

Introduction

The Priorities and Risks Framework "PRF" is a national tool, produced by Audit Scotland, for Auditors to use when planning audits of NHS bodies in Scotland. This tool was piloted in 2003/04 at a number of sites then refined and issued to all auditors in November 2004 for use on the 2004/05 audit and beyond.

The PRF is a comprehensive document identifying approximately seventy risks and a similar number of audit issues over a range of nine topics.

Audit Approach

After consulting the Chief Executive, we met with a number of members of the management team to discuss the full PRF document and obtain senior management's view of the key risks and issues. We also sought their assessment of where Highland Health Board stood in relation to the issues, recognising that these were in the main, emerging issues and it was not therefore expected that completed action would be in place in all cases.

We also reviewed a range of evidence and supporting documentation in order to assist in our own assessment.

A summary of our assessment follows. A summary of our "position statement" with the Board's response is included as Appendix 2.

4.3 Priorities and Risks Framework (cont'd)

PRF Area	Risk Assessment
Governance	Low / Medium
Financial Performance	Medium / High
Performance Management	Medium
People Management	High
Information management	Medium / High
Service Sustainability	Medium / High
Regional Planning	Low / Medium
Partnership Working	Medium / High
Efficient Government	High

4.3 Priorities and Risks Framework (cont'd)

Two issues / risks which affect all areas to varying degrees are:

- The impact of the integration with Argyll and Clyde.
- The impact of the National Shared Services project.

Recommendation

We recommend that the Board ensure that these risks are reflected in the Board Risk Register, to ensure that progress is tracked.

4.4 Primary Care Income and Expenditure

The Practitioners Services Division (PSD) of the Common Services Agency (CSA) have responsibility for calculating and making payments to primary care contractors on behalf of Health Boards.

This expenditure, and related income, is reflected in the accounts of Highland Health Board.

Within Highland Health Board this accounts for approximately £90.5m of expenditure (approximately 26% of net operating costs). We have reported in previous years on the difficulties in implementing an effective payment verification procedure in respect of this expenditure, and potential income.

The payment verification protocol, agreed between the PSD and PCTs identifies five different categories of transactions:

- Patient Exemption Income
- General Medical Services
- Ophthalmology Services
- Dental Services
- Pharmacy Services

Work on the payment schemes is largely covered by a combination of reconciling forecast expenditure against actual, following up exception reports produced from analytical review, and detailed checking by PSD staff.

4.4 Primary Care Income and Expenditure (cont'd)

A new GP contract was introduced in 2004/05. This was designed to simplify the system for payments, and also provide incentives and rewards for GP practices to provide enhanced levels and quality of service.

A quality payment system was also introduced, the Quality and Outcomes Framework (QOF), which relies on a national software system (QMAS) to calculate the quality "score" for each practice on which payments are based.

The Payment Verification Protocol was revised to take account of the new method of payments for GPs and issued to Boards in October 2005. This protocol requires an annual qualitative / supportive visit to all practices and a payment verification visit to 5% (or a minimum of 2) practices. Board staff have carried out practice visits, and this guidance has been followed.

4.4 Primary Care Income and Expenditure (cont'd)

Patient Exemption Fraud / Error

The results of the patient exemption checks for the Highland area for the 12 months ended 31 December 2005 were made available to Directors of Finance in January 2006. Patients can claim exemption from charges in respect of three service streams.

- Dental
- Ophthalmic
- Pharmaceutical

Patient Exemption checks are carried out by the Counter Fraud Service of the CSA. The results of their findings have been reported to the Board analysed by exemption category (44 in all) and by the number of cases investigated, the number where repayment has been made, and the number where the result has been inconclusive and the amounts involved have been written off. The CFS extrapolate the results to project the number and value of fraud claims for the Highland area. This is summarised in the table below. As can be seen, this extrapolation suggests that the loss of income due to fraud or error in the Highland area is in the region of £367,000 (2005 - £344,000).

The small increase is due to a higher level of extrapolated fraud in Pharmaceutical claims (up by 0.3%).

4.4 Primary Care Income and Expenditure (cont'd)

Patient Exemption Fraud / Error (cont'd)

This extrapolation in Highland, however, should be viewed with caution. In pharmacy for example there are fifteen different exemption categories and the CFS sample included twelve of these categories. However, in one category (Age 16-18 and full time education) nineteen cases were examined and five were found to be fraudulent. This is therefore extrapolated into an error rate of 26.3% resulting in an extrapolated error value of £36,958. This is the third highest percentage value in this category in Scotland.

Similarly, in the Pharmacy category "Maternity / Medical exemption", 67 cases were examined, of which 4 were found to be fraudulent, giving an error rate of 6%, the second highest in Scotland. This produced an extrapolated error value of £74,418.

In general fraud rates in Highlands are lower than the Scottish average.

Our overall conclusion is that the level of the extrapolated error is not sufficient to cause us to qualify our opinion on regularity of Primary Care income and expenditure.

EXTRAPOLATED LOSS OF INCOME

	Highland %	£000	All Scotland %	£000
Dental	2.9%	26	3.2%	2,122
Ophthalmic	2.3%	28	2.5%	913
Pharmaceutical	1.5%	283	2.4%	11,035

4.5 Internal Audit

Our relationship with Internal Audit is governed by the Auditing Practices Board Statement ISA610 "Considering the work of Internal Audit".

It is the responsibility of management to determine the extent of the internal control system required. Internal Audit is an important element of the internal control system.

Whenever possible we use the work of the internal auditor to assist us in our assessment of the effectiveness of the internal controls in the Board's main financial systems. However, to enable us to rely on the work of Internal Audit, we need to be satisfied that the audit work has been properly planned, controlled, performed, recorded and reviewed in accordance with the NHS Internal Audit Manual and ISA 610.

We are pleased to confirm that we were able to derive the planned assurance in the areas examined and that the Internal Audit Service was carried out in accordance with NHS Internal Audit Standards.

In 2005/06 we placed reliance on assignments carried out by Internal Audit in the following areas:-

- In Year reporting
- Control Environment
- General Ledger
- Accounts payable
- Payroll
- Debtors

4.6 Management Letters

It is our practice to send interim management letters to the Board's management during the audit year which report, principally, on weakness in internal control. Our recommendations have been responded to positively and appropriate action has been taken by the Board. Other matters arising in the later stages of our audit, are consolidated into an annual management letter, which is issued as soon after the conclusion of our audit as possible.

Our first interim management letter was submitted to the Board on 31 March 2006, and agreed in May 2006.

We also issued a "follow-up" report on progress with recommendations agreed in 2004/05, to the Audit Committee on 29 May.

A further management letter will be issued as part of our final audit.

We expect the Audit Committee to monitor implementation of the Action Plans which form part of the management letters.

4.7 Other Governance responsibilities

Prevention and Detection of Fraud and Irregularities

The respective responsibilities of the Board and ourselves as auditors as set out in Appendix 3. During the year, we reviewed the Board's overall arrangements and Control Environment and made a recommendation in our Interim Management Letter for improvements.

In overall terms, we are satisfied that these arrangements are adequate.

Legality

Again, the respective responsibilities of the Board and ourselves as auditors are set out in Appendix 3.

Our review of the Board's transactions and arrangements has revealed no areas of concern.

Standards of Conduct, Integrity and Openness

We reviewed the Board arrangements in 2005/06 which included:

- Code of Accountability
- Code of Conduct

We are satisfied that these arrangements are satisfactory.

4.7 Other Governance responsibilities (cont'd)

Financial Position

An overall financial strategy and long-term plan is approved for NHS Highland and the Board agrees its annual revenue budget and Capital Programme within this framework.

Regular monitoring reports are submitted to the Board, which reflect actual expenditure to date; revisions to the original plan to take account of changes during the year; and the projected year-end position.

We are satisfied that these arrangements are generally satisfactory.

The wider dimension of the public sector audit requires that the audit process gives consideration to the way in which the Board secures economy, efficiency and effectiveness in its use of resources. These terms are frequently referred to under the generic term Value for Money. Achievement of Value for Money depends on the existence of sound management arrangements, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources.

The Public Finance and Accountability (Scotland) Act 2000 gives the Auditor General the right to initiate examinations into the economy, efficiency and effectiveness in the use of resources.

Contents:

- **Introduction**
- **2005/06 Performance Audit Programme**
- **Best Value**
- **Efficient Government**
- **Local Performance Audit Study**

5.1 Introduction

To comply with our requirements under the Code of Audit Practice we have reviewed the effectiveness of management arrangements at the Board. The aim of this exercise is to ensure that the Board has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Many of these arrangements can also be described as governance arrangements. We comment on Corporate Governance arrangements in section four of this report.

In general terms we were able to conclude that the Board has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources although we have made recommendations as appropriate where we considered procedures could be improved.

5.2 2005/06 Performance Audit Programme

As part of his statutory responsibilities the Auditor General will procure through Audit Scotland examinations of the use of resources and publish reports or guidance. These performance audit reviews promote good management practice and the best use of public money in service delivery. Depending on the nature of the review this work may be carried out by us, as external auditor.

This year, a number of studies have been conducted nationally with no local audit involvement. These include:

- Tackling waiting times
- Implementing the consultants contract
- Information and IM & T study (due August)
- Managing people with long-term conditions (due early 2007)

Information on these, and other studies, is contained in the Audit Scotland 'Health and Community Care' bulletin.

Audit Scotland also design a number of performance audit studies which are conducted across Boards nationally by the local auditors. This year there were no studies which fell into that category.

5.3 Best Value

Since April 2002 there has been a duty of Best Value on Accountable Officers to 'ensure arrangements are in place to secure Best Value'. High level guidance was issued in May 2003, followed by more detailed draft secondary guidance in August 2003. This draft guidance applied to the wider public sector in Scotland (the Scottish Executive and its Executive Agencies, Executive NDPBs, and the NHS). The duty was described in the guidance as:

- To make arrangements to secure continuous improvements in performance; and
- To have regard to economy, efficiency, effectiveness, the equal opportunities requirements and to contribute to the achievement of sustainable development.

In May 2005, Scottish Ministers decided that they would not bring forward legislation which extends Best Value in the wider public sector. However, Ministers did want to encourage and embed the principles of Best Value across the wider public sector, and the Best Value and Performance Team within the Executive were tasked with taking this forward. Revised guidance was issued in May 2006 and is included in the Scottish Public Finance Manual.

In March 2006, in anticipation of this revised guidance, Audit Scotland asked all auditors of NHS bodies to assess the extent of arrangements to support each body's duty of Best Value. The assessment is in four categories – "Not yet planned; Planned; Under development; Well developed". The assessment was discussed and agreed with the Director of Finance, with input from the Chief Executive. It should be noted however that this was the outcome of a high-level review and not a detailed study. The assessment therefore should be viewed in that context.

5.3 Best Value (cont'd)

BV Characteristic

BV Characteristic	Assessment
• Commitment and Leadership	Under development
• Sound Governance at a Strategic and Operational Level	Planned
• Use of Review and Options Appraisal	Under development
• Equal Opportunities Arrangements	Well developed
• Accountability	Under development
• Responsiveness and Consultation	Under development
• Sound Management of Resources and Contractual Relationships	Under development
• A Contribution to Sustainable Development	Planned
• Joint Working	Under development

5.4 Efficient Government

The Scottish Executive spending proposals 2005/2008, published in September 2004, included a commitment to managing public resources more effectively. In November 2004 the "efficient government plan" was published setting efficiency targets across all of the Public Sector for the years to 2007/08. This set out a plan to achieve £745m of cash releasing savings and £300m of time releasing savings by 2007/08. Of this health was targeted to save £166m of cash releasing savings. Five "work stream summaries" were identified being:

- Procurement
- Managing Absence
- Asset Management
- Shared Support Services
- Streamlining Bureaucracy

In January 2006 Audit Scotland issued a "Management Arrangements Diagnostic" to assess how each part of the public sector was preparing to identify, achieve, monitor and report the savings required to meet these targets.

We completed this diagnostic in conjunction with the Director of Finance and other key management team members. In overall terms we found that the Board did not have in place a system designed to measure and report efficiency savings identified by the categories referred to above. However it is clear that the savings plan for 2005/06 is monitored and reported upon to the Board. A savings programme has been identified for 2006/07 to achieved savings of over £16m but the savings are not quantified per project nor are they categorised in accordance with the work streams referred to above.

5.4 Efficient Government (cont'd)

The NHS in Scotland is relying upon the national shared services project to produce efficiency savings under shared support services.

Audit Scotland intend to produce an anonymised national report for the Scottish Executive later this year.

Clearly there will be an expectation that Boards will be able to demonstrate that efficiency targets, as defined in the Scottish Executive proposals, have been met.

Recommendation

The Board should ensure that robust arrangements are in place to demonstrate that Efficient Government savings targets have been met.

5.5 Local Performance Audit Study

As part of our plan for 2005/06 we incorporated an allowance within the agreed fee for a local "Performance Audit" study to be carried out. Audit Scotland advised that this should be on a topic to be agreed with the Board, probably arising out of the "Priorities and Risks Framework" exercise. As yet we have been unable to reach agreement on a suitable topic.

Para Ref	Recommendation	Responsible Officer	Agreed Action	Timescale
2.4	The Board should continue to monitor the achievement of the recurrent savings plan.	Chief Executive	A recurrent saving plan has been prepared agreed and timetabled internally, with 'sign off' by the Executive as part of the Local Development Plan. This is being monitored by the Chief Executive and Chief Operating Officer with formal reporting through the Finance Review Group	Monthly Reports Cycle
	The Board should continue to progress towards a refined financial planning process.	Head of Financial Planning	This work was delayed as a result of the need to address the issues emerging from the 2004/05 Accounts and it will be re-prioritised into 2006/07	December 06
4.3	We recommend that the Board ensure that these risks are reflected in the Board Risk Register, to ensure that progress is tracked.	Chief Executive	The Risk Register already includes the potential risk around Argyll & Bute and National Shared Services and these will be progressed through the associated Action Plans	March 07
5.4	The Board should ensure that robust arrangements are in place to demonstrate that Efficient Government savings targets have been met.	Director of Finance	The need to revise reporting of the Efficient Government savings target has already been recognised with revised reporting arrangements through the Corporate Team and Finance Review Group	September 06

Independent Auditors' Report to the members of Highland Health Board, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of Highland Health Board for the year ended 31 March 2006 under the National Health Service (Scotland) Act 1978. These comprise the Operating Cost Statement, the Balance Sheet, the Cash Flow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice approved by the Auditor General for Scotland and for no other purpose as set out in paragraph 43 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by Audit Scotland, dated July 2001.

Respective responsibilities of the Board, Accountable Officer and Auditor

The board and the Accountable Officer are responsible for preparing the annual report and the financial statements in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers. The Accountable Officer is also responsible for ensuring the regularity of expenditure and income. These responsibilities are set out in the Statement of the Chief Executive's Responsibilities as the Accountable Officer of the Health Board.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and with International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland.

We report our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers. We also report whether in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. We also report if in our opinion, the Foreword is not consistent with the financial statements, if the body has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

We review whether the Statement on Internal Control reflects the board's compliance with the Scottish Executive Health Department's guidance. We report if, in our opinion, it does not comply with the guidance or if it is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the body's corporate governance procedures or its risk and control procedures.

Respective responsibilities of the Board, Accountable Officer and Auditor (cont'd)

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises only the Director's Report, Operating and Financial Review, Remuneration Report, Statement of the Chief Executive's Responsibilities as the Accountable Officer, Statement of the Health Board Members' Responsibilities, and Statement on Internal Control.

We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Auditor General for Scotland. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the board and Accountable Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the body's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Qualified Opinion arising from disagreements about accounting treatment

Financial statements

- (1) As is disclosed in note 25 to the accounts, the Board have entered into an agreement with a contractor to provide and service a Primary Care Resource centre in Invergordon. The Board have accounted for the property concerned as an operating lease and therefore there is no related asset or liability included on the Balance Sheet. In our opinion, the Board should have accounted for this asset as a finance lease and included a fixed asset and a related liability on the Balance Sheet. Had the Board adopted this treatment it would have increased the fixed assets by £8.7m and long-term liabilities by a similar amount. As a result operating lease charges would reduce by £1.067m, depreciation would increase by £0.223m, and finance charges would increase by £0.994m, resulting in a net additional charge of £0.15 million being made in the Operating Cost Statement.
- (2) As is also disclosed in note 25 to the accounts, the Board entered into an agreement with a contractor to provide a hospital at New Craigs, which opened in July 2000. The property element of the agreement meets the definition of and has been accounted for as a finance lease. However the total finance charges inherent in the finance lease element of the agreement have been allocated on an equal basis each year over the 25 year lifetime of the lease. This is not in accordance with the Statement of Standard Accounting Practice 21 (SSAP21), which requires the finance charge element to be allocated so as to produce a constant periodic rate of charge on the remaining balance of the obligation for each accounting period. Had the Board adopted this treatment it would have increased the net liability disclosed in note 25 by £2.6m. The charge to the Operating Cost Statement for the year would have increased by £0.4m, with the balance being accounted for as a prior period adjustment.

Qualified Opinion arising from disagreements about accounting treatment (cont'd)

Except for the financial effects of the omission of the fixed asset and related liability (1), and the incorrect allocation of finance charges (2), referred to above, in our opinion

- the financial statements give a true and fair view, in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers, of the state of affairs of the board as at 31 March 2006 and of its surplus, total recognised gains and losses and cash flows for the year then ended: and
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers.

Regularity

In our opinion in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Tenon Audit Limited
10 Ardross Street
Inverness
IV3 5NS

June 2006

PRF Area	Risk Assessment 1 to 5 (Low to High)	Comments on Key Issues Arising	Risks	Board Comments / Actions
General		Two issues/risks which permeate throughout are: <ul style="list-style-type: none"> ▪ The impact of the National Shared Service project. ▪ The impact of the integration with Argyll and Bute. 	Potential loss of financial or operational control or undue time spent on these issues.	Recognised at early state in risk register with specific management actions into specific aspects.
Governance	2/3	Review of governance by Chair and Chief Executive just completed.	New arrangements still to be tested.	Agreement by Board against background of overall business environment, including those above.
Financial Performance	3/4	Planning group established to: <ul style="list-style-type: none"> • Oversee production of five-year financial plan. • Develop revised financial planning process. • Integrate Argyll and Bute into planning process. 	<ul style="list-style-type: none"> • Risk of deficit for year. • Plans to reduce deficit to £0.6m. • £2.1m of £7.3m CRES still to be identified. 	Upgraded financial reporting and management leading to financial breakeven at year end, including full achievement of CRS albeit on a non recurrent basis.

PRF Area	Risk Assessment 1 to 5 (Low to High)	Comments on Key Issues Arising	Risks	Board Comments / Actions
Performance Management	3	Improved monitoring reports to board, but still needs some refinements. Cost cube still to be fully implemented.	<ul style="list-style-type: none"> • Availability of validated source data. • No system to allow comparison of inputs to outcomes. 	Refined reporting to NHS Board, linking both detailed data and accessible overall monitoring. Cost Cube development ongoing with focus on overall financial management during the year.
People Management	4	No IT system for workforce information – dependent on successful implementation of SWISS. Recent appointment of workforce planning officer.	<ul style="list-style-type: none"> • No firm timetable for full implementation of AfC (Target end date of December 2006) <p>Other risks identified:</p> <ul style="list-style-type: none"> • The reliability of the financial model for projecting the back pay element of AfC. 	<p>Maximisation of use of existing data – such as employee statistics from Payroll / Ledger systems pending national developments of SWISS.</p> <ul style="list-style-type: none"> • AFC costs assessed on regular basis, through local application of national model, together with peer review as additional check with additional provisions made in 05/06 to recognise this risk.

PRF Area	Risk Assessment 1 to 5 (Low to High)	Comments on Key Issues Arising	Risks	Board Comments / Actions
			<ul style="list-style-type: none"> • Recruitment of GPs for OOH. • Sustaining services in remote locations. • Pressure on management capacity. • Integration of workforce plans into strategic plans. 	<ul style="list-style-type: none"> • No GP recruitment/retention problem. • Ongoing service delivery in remote area. • Management continue to deliver full agenda, including performance and integration. • Workforce Plan submitted.
Information Management	3/4	No separate risk assessment for IT.	<ul style="list-style-type: none"> • No formal business continuity plan. • Series of continuing changes has made it difficult to formally define information requirements. • Impact of AfC on recruitment and retention of staff. 	<ul style="list-style-type: none"> • Business continuity plans under preparation. • Active eHealth Strategy Group to progress agenda. • Continued staff recruitment and retention in line with operational requirements.

PRF Area	Risk Assessment 1 to 5 (Low to High)	Comments on Key Issues Arising	Risks	Board Comments / Actions
Service sustainability	3/4	Some outstanding queries to be cleared.	<ul style="list-style-type: none"> • overall “vision” not yet in place (Provisional document derailed by Argyll and Bute) – this has delayed finalisation of supporting strategies e.g. Property strategy. • Management capacity under assessment. 	<ul style="list-style-type: none"> • Vision document developed as basis for future strategic direction, and to facilitate Argyll and Bute integration work. • Management continue to deliver wide agenda.
Regional Planning	2/3	<ul style="list-style-type: none"> • HHB Chief Executive is Chairman of NOSP. • Plans for medium secure unit to be jointly funded and built in Perth. 	Introduction of national tariffs.	National implementation delayed pending additional input/assessment.
Partnership Working	3/4	Argyll and Bute CHP already established as CHP but not on same basis as other HHB CHPs.	<ul style="list-style-type: none"> • No separate risk assessment for CHPs – but, limited power devolved – mainly advisory role. • No CHP performance management frame work. 	<ul style="list-style-type: none"> • CHPs involved in risk assessment workshops and CHP Risk Groups. • Performance management through DHS Committee (up to 31/3/06) and Board.

PRF Area	Risk Assessment 1 to 5 (Low to High)	Comments on Key Issues Arising	Risks	Board Comments / Actions
			<ul style="list-style-type: none"> • Difficulty in engaging partners at all levels in CHP development. • Difficulty in sharing case specific information. • Demographic changes are major risk. 	<ul style="list-style-type: none"> • CHP Committees managing the business. • Information exchange project underway. • Population / patient planning as part of service proposals.
Efficient Government	4	Focus is on achieving savings to enable a balanced financial position – not necessarily on identifying and reporting by the definitions and categories included in Efficient Government guidance.	<ul style="list-style-type: none"> • No formal system in place to monitor and report savings per the guidance. • Difficulty in identifying and achieving recurring savings. • No formal programme of Best Value reviews or Benchmarking. 	<ul style="list-style-type: none"> • Savings reported to NHS Board as part of Finance Report. • Higher level of non recurrent savings in 2005/06 leading to revised approach in 2006/07. • Benchmarking and best value used as tools within service planning and review.

Risk Assessment

The Board's Responsibility

It is the responsibility of the Board to identify and address its operational and financial risks and to develop and implement proper arrangements to manage them, including adequate and effective systems of Internal Control.

This includes:

- Completion of a Statement on Internal Control (see 4.1)
- Management of exposure to Medical and Clinical negligence claims (see 3.4)
- Maintenance of systems of internal control

The Role of Tenon Audit Limited

In planning our audit, we consider and assess your risk management arrangements as part of our assessment of audit risk. This helps us to tailor our audit plans so that they are both appropriate to your circumstances and directed to the areas of greatest risk. We also complete a review of these arrangements as part of our final accounts audit work relating to the Internal Control Statement (see 4.1).

Systems of Internal Control

The Board's Responsibility

The Board has a responsibility to develop and implement systems of internal control, including risk management, and systems of financial, operational and compliance controls. For all NHS bodies, it is mandatory to at least annually conduct a review of the effectiveness of the systems of internal control and report publicly that they have done so. This review should take account of the work of Internal Audit and should usually be carried out through the Audit Committee.

Three components of the system of risk management are:

- Timely identification of key business risks
- Consideration of the likelihood of the risks crystallising and the significance of the consequential financial or other impact
- Establishment of priorities for the allocation of resources to control risk and the setting and communicating of key objectives.

The monitoring of controls provide assurance that managers are assessing the existence of risk and the effectiveness of controls over the risks. The internal audit arrangements form an important part of management's monitoring and review of internal control arrangements, and in ensuring that appropriate monitoring or risks and controls takes place.

Systems of Internal Control (cont'd)

The Role of Tenon Audit Limited

In broad terms the external auditor is expected to assess the internal controls in the Board's main financial systems and report on any significant control weaknesses identified. This does not absolve management from its responsibility for the maintenance of an adequate internal control system.

Through the results of our own testing, and our reliance on areas examined by Internal Audit, we have concluded that the fundamental key financial systems of the Board are generally operating satisfactorily.

We have made suggestions for improvements to procedures where appropriate, in management letters (see section 4.6).

The systems reviewed were as follows:

- Control Environment (IA)
- Regularity
- Fraud and Corruption Procedures
- In-Year Reporting (IA)
- General Ledger and Control Accounts (IA)
- Computers and IT
- Cash and Bank
- Accounts Payable (IA)
- Payroll (IA)
- Patients Travel
- Debtors (IA)
- Primary Care
- Service Level Agreements
- Code of Accountability
- Code of Conduct
- Capital Expenditure
- Asset Register
- Stores
- Treasury Management
- Evaluation of Internal Audit

(IA) indicates where we were able to place reliance on work performed by Internal Audit.

Prevention and Detection of Fraud and Irregularities

The Board's Responsibility

It is the responsibility of the Board to establish arrangements to prevent and detect fraud and other irregularity. It therefore needs to put in place proper arrangements for:

- 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 allegations of breaches of proper standards of financial conduct or fraud and irregularity.

The Role of Tenon Audit Limited

External audit is required to review the adequacy of the measures taken by the Board, to test compliance, and to draw the attention of management to any weaknesses or omissions.

Legality

The responsibility for ensuring the legality of all activities and transactions rests with the Board.

The responsibility of the external auditor is to review the legality of the Board's transactions and to be aware of the requirements of statutory provisions.

Standards of Conduct, Integrity and Openness

The Board's Responsibility

It is the responsibility of the Board to ensure that its affairs are managed in accordance with proper standards of conduct. It needs therefore to put in place proper arrangements for:

- Implementing and monitoring compliance with appropriate guidance on standards of conduct
- Expressing and promoting appropriate values in standards across the authority
- Developing, promoting and monitoring compliance with Codes of Conduct that advise Members, Officers or Managers of their personal responsibilities and expected standards of behaviour
- Developing, promoting and monitoring compliance with standing orders and financial instructions.

The Role of Tenon Audit Limited

It is our role to consider whether the Board has put in place adequate arrangements to maintain and promote proper standards of financial conduct and to prevent and detect corruption. We discharge this duty by reviewing and where appropriate examining evidence that is relevant to these arrangements.

Financial Position

The Board's Responsibility

It is the responsibility of the Board to conduct its affairs and put in place proper arrangements to ensure that the financial position is soundly based having regard to:

- Financial monitoring and reporting arrangements
- Compliance with statutory financial requirements and achievement of financial targets
- Levels of balances and reserves
- The impact of planned future policies and known or foreseeable future developments

The Role of Tenon Audit Limited

It is our role to consider whether the Board has established adequate arrangements. We are also required to have regard to going concern as part of the audit of the financial statements. In carrying out this responsibility we consider:

- Financial performance in the year
- Compliance with statutory financial requirements and financial targets
- Ability to meet known statutory and other financial obligations, actual or contingent
- Responses to known developments which may have an impact on the Board's financial position

Financial Statements

It is the responsibility of the Board to:

- Ensure the regularity of transactions by putting in place systems of internal control.
- Maintain proper accounting records.
- Prepare financial statements which present a True and Fair view of the state of affairs of the Board and its net operating cost, total recognised gains and losses, and cash flows in accordance with the Accounts Manual.

We are required to give an opinion on:

- whether the accounts present a True and Fair view of the state of affairs of the Board and its net operating cost, total recognised gains and losses, and cash flows for the period.
- whether the accounts and the part of the Remuneration Report to be audited have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
- the regularity of expenditure and income.

In carrying out this responsibility we provide reasonable assurance that, subject to the concept of materiality, the financial statements and the part of the Remuneration Report to be audited:

- Are free from material misstatement.
- Comply with the statutory and other requirements applicable.
- Comply with relevant requirements for accounting presentation and disclosure.

Corporate Governance

Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. The three fundamental principles apply:-

- Openness
- Integrity
- Accountability

Highland Health Board has a responsibility to put in place arrangements for the conduct of its affairs, ensure the legality of activities and transactions, and to monitor the adequacy and effectiveness of these arrangements.

We have a responsibility to review and, where appropriate, report findings on the Board's corporate governance arrangements as they relate to:-

- The Board's review of its systems of internal control including its reporting arrangements.
- The prevention and detection of fraud and irregularity.
- Standards of conduct and arrangements in relation to the prevention and detection of corruption.
- The financial position of the Board.

Our work has focused upon our review of the Board's Risk Management arrangements, systems of internal control, Internal Audit, consideration of the controls to prevent and detect fraud and corruption, and the audit of the final accounts.

In giving an opinion on the accounts our audit strategy requires us to ensure that the fundamental financial systems are adequately covered each year. Whenever possible, to avoid duplication of effort, we seek to rely on the work of Internal Audit.

However, our work cannot cover every financial activity and accounting procedure. We plan and perform our audit to give reasonable assurance that the statements are free from material misstatement and that they comply with statutory and other requirements.

HIGHLAND HEALTH BOARD

**YEAR ENDED 31 MARCH 2006
FINAL REPORT OF THE EXTERNAL AUDITORS
TO THE MEMBERS OF HIGHLAND HEALTH BOARD AND THE
AUDITOR GENERAL FOR SCOTLAND**

JUNE 2006

The purpose of this report is to give a summary of our audit activity. It includes details of the more significant matters arising from the audit, sets out the respective responsibilities of Management and external audit, and reports what action has been taken or is necessary by Board members or executive management.

Our audit of Highland Health Board for the year ended 31 March 2006 has been carried out in accordance with statutory requirements and follows the practices prescribed by the Code of Audit Practice. The Code of Audit Practice sets out fully the responsibilities of the Board and its officers in relation to financial probity, control, preparation of accounts and the achievement of value for money in the provision of services. We are required under the Code to give an independent assessment of how the Board has discharged its stewardship of public funds. A summary of our responsibilities is contained in Appendix 3.

This report is part of a continuing dialogue between the Board and ourselves and is not, therefore, intended to cover every matter which came to our attention. For this reason we do not accept responsibility for any reliance that third parties may place upon it.

We have summarised the Key Issues arising from our audit in Section One. In providing the summary, it can be difficult to strike a balance between recognising good performance when achieved and highlighting scope for improvement. The items referred to represent Key Issues for management attention and should not be taken out of the context of the remainder of this report, or the detailed reports covering individual reviews. Our responsibilities are explained in our separate "Audit Responsibilities" document and are summarised in Appendix 3.

- We invite Highland Health Board to receive this report and consider the recommendations we have made.*
- We would be grateful to receive the Board's response to the issues we have raised.*

Tenon audit

Summary of how we have discharged our audit responsibilities

Audit Responsibilities	Summary for Members
<p>To give an opinion on:</p> <ul style="list-style-type: none"> whether the financial statements and the part of the Remuneration Report to be audited present a true and fair view of the financial position of the Board. whether the financial statements have been properly prepared in accordance with the National Health Service (Scotland) Act and directions made thereunder. 	<p>Our opinion is based on our:</p> <ul style="list-style-type: none"> review of certain financial systems; year end regularity audit of the Board's financial statements and; assessment of Internal Audit and review of their examination of the Board's financial systems. <p>A qualified audit opinion was given on the Board's financial statements.</p> <p><i>See details at Section 3 & 4</i></p>
<p>To give an opinion on the regularity of the income and expenditure shown in the accounts.</p>	<p>An unqualified opinion has been given in respect of regularity.</p> <p><i>See details in Section 3</i></p>
<p>To review the Statement of Directors' Responsibility in respect of Internal Control.</p>	<p>We have reviewed information provided by the Board in support of the Statement. Our opinion on the content of the Statement is unqualified.</p>
<p>To consider whether the Board has achieved its financial targets, and draw attention, in our report, to instances where they are not achieved.</p>	<p>All of the financial targets have been achieved.</p> <p><i>See details in Section 2</i></p>
<p>To review the summarisation spreadsheet package for consistency with the final audited accounts.</p>	<p>We have reviewed the summarisation spreadsheet package, and have issued an unqualified report.</p> <p><i>See details in Section 3</i></p>
<p>To consider and assess the Corporate Governance arrangements of the Board.</p>	<p>We have reviewed the Board's Corporate Governance arrangements and have concluded that they are satisfactory.</p> <p><i>See details in Section 4</i></p>
<p>To review and report on the arrangements to manage performance designed to secure economy, efficiency and effectiveness in the use of resources.</p>	<p>In general the Board's arrangements are satisfactory.</p> <p><i>See details in Section 5</i></p>

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