Overview of the financial performance of the NHS in Scotland 2005/06

Prepared for the Auditor General for Scotland

December 2006

AUDIT SCOTLAND

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Summary

The financial position of the NHS in Scotland has moved from an overspend of £32 million in 2004/05 to an underspend of £70.6 million in 2005/06.

Introduction

1. This report provides a financial overview of the NHS in Scotland in 2005/06. The annual accounts for 2005/06 cover a year where the NHS continued to develop single system working and establish new structures in the form of Community Health Partnerships (CHPs).

2. The NHS in Scotland spent almost £9 billion in 2005/06 (this is net of operating income), representing around a third of the total spend in the public sector. It remains Scotland's largest employer with over 150,000 staff (almost 130,000 whole time equivalent) providing care in community, primary and acute settings throughout the country.

3. Despite record increases in funding, the NHS continues to face challenges over the coming years which will require robust long-term financial and service planning. These include a range of cost pressures such as the UK-wide pay modernisation agenda, the increasing cost of drugs and rising energy prices. In addition, technical advances in the way in which healthcare can be delivered, changing training requirements for medical staff and a growing older population all contribute to the need to change the way in which health and related services are delivered.

4. NHS Argyll and Clyde was dissolved on 31 March 2006. Comments on the board's annual accounts for 2005/06 and the financial implications of its dissolution on the two successor boards (NHS Greater Glasgow and Clyde and NHS Highland) are included in this report.

Summary of key messages

5. Funding for the NHS in Scotland was almost £9 billion in 2005/06 and is planned to reach £10 billion by 2007/08.

6. The financial position of the NHS in Scotland (including the Scottish Executive Health Department and the 24 NHS bodies) has moved from an overall overspend of £32 million in 2004/05 to an overall underspend of £70.6 million against the health budget for 2005/06. Most of this relates to an underspend on capital.

7. At the end of 2005/06, NHS Argyll and Clyde received £82.3 million from the Scottish Executive Health Department (SEHD) to write off its £81.7 million cumulative deficit. Excluding NHS Argyll and Clyde, the total cumulative revenue underspend for the remaining 23 NHS bodies increased by £4.9 million to £69 million in 2005/06.

8. Two of the 24 NHS bodies failed to meet one of their financial targets (NHS Lanarkshire and NHS Western Isles), and the annual accounts for NHS Highland were qualified.

9. NHS bodies are expected to contribute to the Efficient Government Initiative by making £523 million savings by 2007/08. Cash-releasing savings are being reported across the NHS; less savings have been reported from time-releasing activities.

10. Most NHS boards are making progress in setting up structures and governance arrangements to support single system working but the transition has been more challenging for some of the larger NHS boards. Governance arrangements for the new CHPs are at an early stage.

Information sources

11. The commentary on financial performance and governance is based largely on the audited accounts and auditors' reports on the 2005/06 audits of the 15 NHS boards, nine special boards and the SEHD.[1] Auditors' reports are available on Audit Scotland's website.[2] The final financial positions in 2005/06 for the NHS boards and special boards are shown at Appendix 1 (page 27). For ease of reference, figures in the main body of the report have been rounded.

12. NHS financial performance cannot be considered in isolation from overall performance and service delivery, so this report should be considered alongside our overview report on the performance of the NHS published in December 2005.[3] Our next performance overview report on the NHS will be published in December 2007.

13. We have tried to minimise the use of technical terms, but in some places this is unavoidable and we have therefore included a glossary at Appendix 2 (page 28).

1 For the purposes of this report, NHS National Services Scotland and the Mental Welfare Commission are referred to as NHS special boards. The Mental Health Tribunal for Scotland is an executive agency and is responsible for laying its own accounts in Parliament, and so is excluded from this report.
2 http://www.audit-scotland.gov.uk
3 *An overview of the performance of the NHS in Scotland 2004/05,* Audit Scotland, December 2005.

All NHS bodies met the new deadline for submitting their audited accounts to the Scottish Executive Health Department

14. The SEHD brought forward the deadline for the submission of audited accounts from 31 July to 30 June for the 2005/06 annual accounts. This meant that the timetable for preparing accounts and completing the audits was tight. All NHS accounts were audited and submitted by the revised deadline. The majority of auditors reported that the audit process ran smoothly and that draft accounts and supporting schedules were of a good standard.

Supporting continuous improvement through audit

15. The audit process is essentially risk based and provides an independent and objective examination of the financial affairs of NHS bodies. The audit process is not only about holding audited bodies to account but also aims to support continuous improvement by making recommendations in management reports and final audit reports, and monitoring progress against agreed action plans. Final audit reports to NHS bodies focus on issues of real importance, and challenge and support NHS bodies in managing major risks and improving performance.

16. We highlight a number of issues about financial performance in this report. Auditors will continue to monitor the financial performance of NHS bodies during 2006/07.

17. This report is organised into three main parts:

- Part 1 outlines recent organisational change in the NHS in Scotland and provides a commentary on some of the key challenges facing the health service.
- Part 2 considers financial performance in 2005/06.
- Part 3 reports on how governance arrangements are keeping pace with organisational change across the NHS in Scotland.

Part 1. Setting the scene

The NHS in Scotland has undergone major reorganisation in the last three years

18. The structure of the NHS in Scotland has changed significantly over the last three years, including:

- The establishment of single system working, dissolving trusts and developing 15 unified NHS boards. The aim of establishing boards as single systems was to remove organisational barriers and to establish shared aims and clear lines of accountability across NHS board areas.
- The development of CHPs to improve collaborative working between primary and acute healthcare, and between health and local authority partners.
- More recently the dissolution of NHS Argyll and Clyde and the transfer of the board's services and responsibilities to NHS Greater Glasgow and Clyde and NHS Highland. This reduced the number of NHS boards from 15 to 14 from April 2006.

Funding for the NHS in Scotland reached almost £9 billion in 2005/06

19. The Scottish Parliament voted £7.5 billion for the NHS in Scotland for 2005/06. In addition, the NHS received income of around £1.5 billion from national insurance contributions. The total funding available for the NHS in Scotland in 2005/06 was almost £9 billion (£8.65 billion revenue and £0.305 billion capital).

20. The NHS consolidated outturn statement shows that NHS bodies received £8.43 billion (revenue) for the year ended 31 March 2006. This left £220 million from the revenue budget to meet the SEHD's running costs and centrally funded healthcare programmes.

Planned expenditure on health in Scotland will have grown by almost 40 per cent over the five years to 2007/08

21. The health budget has increased in real terms by 18 per cent over the last three years and is planned to rise by almost 40 per cent over the five years to 2007/08 (Exhibit 1 overleaf). Much of this growth in funding has been to develop patient services, increase staff numbers, reform staff pay structures and drive down waiting times.[4]

Spending on healthcare in Scotland is relatively high compared to other UK countries

22. In 2004/05, Scotland spent more on healthcare per head of population compared with the rest of the UK (Exhibit 2 overleaf). Budgeted expenditure on health in Scotland for 2005/06 was over 13 per cent higher than the UK average of £1,481 per head of population.[5]

4 *Our National Health: A plan for action, a plan for change*, Scottish Executive, 2001.
5 *The Scottish Executive draft budget for 2007/08*, Scottish Executive, September 2006.

Exhibit 1

Funding for the NHS in Scotland, 2002/03 to 2007/08

NHS funding will increase by almost 40 per cent over the five years to 2007/08.

Note: These figures are adjusted to 2006 prices.

Source: The Scottish Executive draft budget for 2007/08, Scottish Executive, September 2006

Exhibit 2

UK spend on healthcare per head of population, 2004/05

Scotland spends more on healthcare per head of population compared with the rest of the UK.

Source: Public Expenditure Statistical Analysis (PESA) 2006, HM Treasury/Office for National Statistics, May 2006

Exhibit 3

SEHD's estimates of the additional costs of pay modernisation agreements

The NHS in Scotland spent an additional estimated £291 million on implementing the new pay modernisation agreements in 2005/06.

Pay modernisation	Estimated additional costs in 2004/05 £ million	Estimated additional costs in 2005/06 £ million	Estimated additional costs in 2006/07 £ million	Estimated additional costs in 2007/08 £ million
Consultant contract	31	16	18	19
GMS contract	71	69	See note 1	See note 1
GMS out-of-hours	14	16	0	0
Agenda for Change	155	190	189	140
Total	271	291	207	159

Notes:
1. GMS contract pay negotiations are ongoing and estimated additional costs for 2006/07 and 2007/08 were not available at the time of publication.
2. The cost estimates are in-year costs only. They are not cumulative.

Source: Unpublished data from Scottish Executive Health Department, October 2006

The NHS in Scotland faces a number of major challenges

23. Making sure that the large sums of public money allocated to the NHS lead to better patient services and outcomes requires sound planning, good financial management, robust monitoring and effective leadership at a national and local level. Ensuring that the additional investment in the NHS adds value is even more of a challenge given the recent scale and pace of change, and increased public expectations. Some of the major challenges are outlined in the rest of this section.

The NHS is the largest employer in Scotland

24. The NHS is Scotland's largest single employer with about 154,000 staff or 6.3 per cent of the total workforce in Scotland.[6 7] The NHS in Scotland currently spends around half of its budget on staff, excluding independent contractors such as GPs and community pharmacists.

25. There have been a number of major changes which affect staffing and present particular challenges for NHS management and clinical practice. These include:

- three UK-wide pay modernisation agreements – the consultant contract, the new General Medical Services (GMS) contract and Agenda for Change
- the European Working Time Directive and ensuring compliance with reductions in the hours that junior doctors can work
- NHS policies of no compulsory redundancies and a no detriment rule for existing staff whose jobs change. The no detriment rule means that pay and terms and conditions are protected for staff whose jobs change as a result of reorganisation.

26. The pay modernisation agenda is currently one of the largest cost pressures faced by the NHS. The additional costs of implementing the new pay agreements are estimated at £291 million for 2005/06 and at least £207 million for 2006/07 (Exhibit 3). The largest pay stream is Agenda for Change and some boards are still in the process of calculating the full cost of this. The SEHD estimates that there will be no additional costs for GMS out-of-hours in 2006/07 and 2007/08.

The NHS is managing its surplus estate and changing its infrastructure

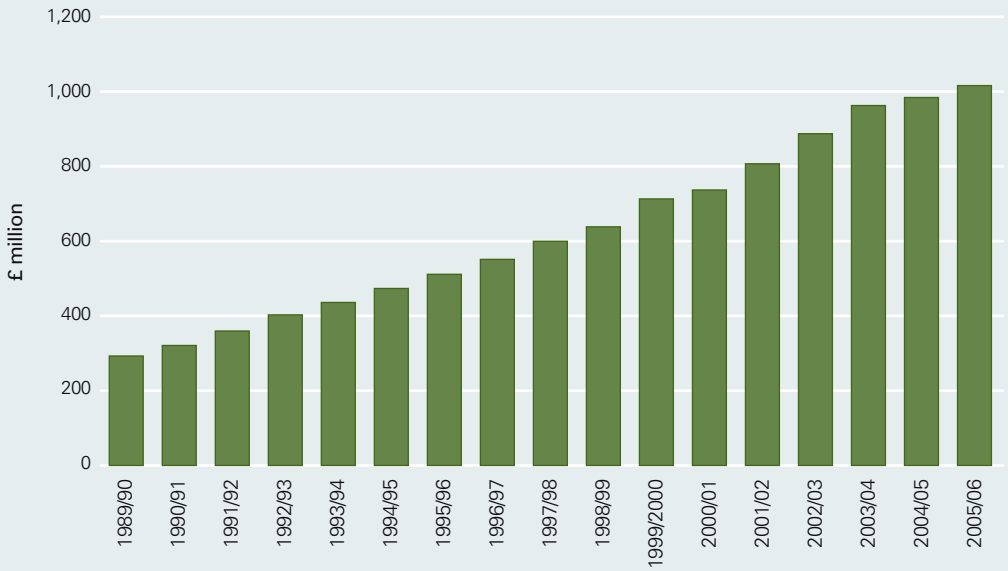
27. The NHS in Scotland has fixed assets valued at £4.4 billion, resulting in capital charges of around £335 million each year.[8] As the NHS moves away from hospital-based services and develops alternative community services, such as enhanced primary care centres, this will affect the NHS estate.

6 NHS in Scotland Workforce Statistics as at 30 September 2005, Information Services Division (ISD), 2005.
7 Public Sector Employment in Scotland statistics as at June 2005, Scottish Executive, June 2005.
8 *NHS Scotland consolidation of NHS annual accounts*, 2005/06.

Exhibit 4

Gross cost of prescriptions in the community, 1989/90 to 2005/06 (unadjusted)

The cost of prescriptions dispensed in the community has been rising year on year.



Source: Prescribing update, ISD, September 2006

28. The NHS in Scotland can make use of Private Finance Initiative (PFI) agreements to develop its estate. Data from the Scottish Executive show that there are currently 49 PFI contracts in operation across the NHS in Scotland with a capital value of approximately £553 million. A further 31 PFI contracts are planned with a capital value totalling £982 million.[9] The first PFI contracts in the NHS in Scotland became operational in 1992 and typically last for 25 years or more.

29. Rather than owning an asset (such as a hospital building) and paying for its build from their capital budget, PFI agreements mean that NHS bodies pay annual charges out of their revenue budget to their PFI partners. This adds to the need for NHS bodies to plan for the impact of PFI payments on their revenue budgets and to manage these.

The cost of drugs is rising year on year

30. Expenditure on prescription drugs and drugs used in hospitals amounted to just over £1 billion and £212 million respectively in 2005/06.[10]

31. The cost of drugs prescribed in the community has risen significantly since 1990 (Exhibit 4).[11] In recent years however, the rise has slowed. This is likely to reflect a greater use of cheaper generic medicines, drugs coming off patent and most recently the drugs price regulation scheme. The overall growth reflects increased availability of medicines; guidelines recommending the use of medicines, such as statins, for a wider range of conditions; and people living longer with a range of health conditions that can be managed with medicines.

Clinical services are being redesigned

32. *Building a Health Service Fit for the Future* (the Kerr report) highlighted that more than a quarter of the population in Scotland will be over 65 within 25 years.[12] The report recommends that all NHS boards establish a systematic approach to caring for the most vulnerable with long-term conditions (particularly older people).

33. Implementing the changes envisaged in *Delivering for Health* (the Scottish Executive's response to the Kerr report) will require NHS boards to change the way in which services will be delivered.[13] This will be a considerable challenge for the NHS, and will require strong financial management and effective planning involving patients and clinicians. Reconfiguring services means that

9 Scottish Executive Private Finance and Capital Unit, October 2006.
10 *Scottish Health Service Costs* (Cost Book), ISD, December 2006.
11 *Prescribing costs update*, ISD, September 2006.
12 *Building a Health Service Fit for the Future. A National Framework for Service Change in the NHS in Scotland*, Scottish Executive, May 2005.
13 *Delivering for Health*, Scottish Executive, November 2005.

surplus assets may be disposed of to free up resources for reinvestment. This means that boards face a temporary increase in cost pressures from accelerated depreciation charges. Service redesign may also involve increased running costs for a transitional period to ensure that there are no disruptions to existing services. The financial impact of redesigning services needs careful planning to ensure clinical services continue to operate effectively.

The new tariffs are expected to be cost-neutral but may be a future cost pressure for some boards

34. *Delivering for Health* included a commitment to introduce national tariffs for hospital procedures. The national tariff will set prices for activity carried out by one NHS board for patients who reside in another board area. This is intended to simplify the process for service level agreements for cross boundary work, improve the accuracy of cost and activity data, and encourage benchmarking among NHS boards.

35. The application of the national tariff to cross-boundary activity will be phased and started with two specialties in 2005/06 – Orthopaedics and Cardiothoracic Surgery. Tariffs will be extended to a further six specialties in 2006/07 (eight in total).

36. The implementation of tariffs is expected to be cost-neutral across the NHS in Scotland. However, several of the smaller boards (including the island boards) have highlighted that tariffs may be a cost pressure in 2006/07 and beyond. We will consider tariffs in more detail as part of our NHS overview report in 2006/07.

NHS boards have identified increasing energy prices as a cost pressure

37. The latest update on quarterly energy prices by the Department of Trade and Industry showed that the overall price paid for fuel and light in real terms had risen by 12 per cent between the first quarters of 2005 and 2006. The price of heating oils increased by 27.4 per cent over the same period.[14] Rising energy prices will be a cost pressure for all NHS boards and plans should be in place to address these.

38. Two boards reported that they had exceeded their budgeted costs for energy in 2005/06 (Dumfries and Galloway and Lanarkshire) and two further boards have identified rising energy prices as a potential cost pressure in 2006/07 (Borders and Lothian). In 2005/06, NHS Lanarkshire exceeded its energy budget by over £1 million and NHS Borders is setting aside an additional £750,000 in 2006/07 to meet increases in energy costs.

14 *Energy Trends and Quarterly Energy Prices*, Department of Trade and Industry, June 2006.

Part 2. Financial performance

Key messages

- The financial position of the NHS in Scotland (including the SEHD and the 24 NHS bodies) has moved from an overall overspend of £32 million in 2004/05 to an overall underspend of £70.6 million against the health budget for 2005/06. Most of this relates to an underspend on capital.
- At the end of 2005/06, NHS Argyll and Clyde received £82.3 million from the SEHD to write off its £81.7 million cumulative deficit. Excluding NHS Argyll and Clyde, the total cumulative underspend for the remaining 23 NHS bodies increased by £4.9 million to £69 million in 2005/06.
- Two of the 24 NHS bodies failed to meet one of their financial targets (NHS Lanarkshire and NHS Western Isles), and the annual accounts for NHS Highland were qualified.
- NHS bodies are expected to contribute to the Efficient Government Initiative by making £523 million savings by 2007/08. Cash-releasing savings are being reported across the NHS; less savings have been reported from time-releasing activities.

The NHS in Scotland as a whole has an underspend against its overall budget, most of which relates to capital

39. The NHS in Scotland as a whole (SEHD and NHS bodies) had a small overspend of £176,000 against its overall revenue budget (£8.6 billion) and an underspend of £70.8 million against its overall capital budget (£305 million) in 2005/06. This amounts to a total underspend of £70.6 million against the overall budget (Exhibit 5). This compares to a £32 million overspend in 2004/05.

40. The SEHD was forecasting an underspend of £44 million against the overall NHS revenue budget in May 2006, which was largely due to NHS Argyll and Clyde's cumulative deficit being cleared during 2005/06. The SEHD used some of its surplus funds held in the Scottish Executive's Central Unallocated Provision (CUP) to clear this.

41. The SEHD was also forecasting an underspend of £25 million against the capital budget (£305 million), resulting in a total forecast underspend of £69 million against the health budget for 2005/06. The final position for 2005/06 was a £70.6 million underspend (Exhibit 5).

42. The SEHD faced particular financial pressures in 2005/06 due to the overspend of £32 million for the NHS in Scotland as a whole in the previous year. The auditor has reported that the SEHD completed an internal review of financial management and budgetary control during 2005/06 and is now in the process of restructuring its finance function. The SEHD has asked its auditor to do a joint review with internal audit of the new arrangements during 2006/07.

Exhibit 5

NHS in Scotland outturn against funding from the Scottish Parliament and National Insurance contributions

The NHS in Scotland spent a total of £8,884.8 million in 2005/06. This resulted in an underspend of £70.6 million against its overall budget.

NHS in Scotland	2004/05 £ million	2005/06 £ million
Revenue budget	7,965.7	8,650.4
Capital budget	193.0	305.0
Total budget	**8,158.7**	**8,955.4**
Revenue expenditure	8,000.7	8,650.6
Capital expenditure	190.0	234.2
Total expenditure	**8,190.7**	**8,884.8**
Revenue underspend/(overspend)	(35.0)	(0.2)
Capital underspend/(overspend)	3.0	70.8
Total underspend/(overspend)	**(32.0)**	**70.6**

Note: Includes the SEHD and the 24 NHS bodies. This also covers wider spend on health improvement and health-related community care.

Source: Scottish Executive Health Department Final Audit Reports 2004/05 and 2005/06

Most NHS bodies met their three financial targets

43. The SEHD has three financial targets for NHS bodies. The targets are they should stay within their:

- Revenue resource limit (RRL) – this is the revenue budget allocated for the day to day operation of services. Underspend against the RRL, where approved, may be carried forward to the next year; any overspend has to be carried forward and is then deducted from the RRL allocation in the following year.
- Capital resource limit (CRL) – the funding that a health body has available for capital programmes. NHS bodies normally return any surplus CRL to the SEHD for re-allocation in the following financial year.
- Cash requirement – this is the amount of cash drawn down by NHS bodies to fund ongoing operational costs and new capital investment.

44. The total RRL outturn for all NHS bodies was an underspend of £69.6 million in 2005/06 (Exhibit 6 overleaf). The overall underspend for NHS boards was £45.4 million and £24.2 million for special boards. This compares to an overall underspend of £4.6 million in 2004/05.

45. While this appears to represent a significant movement in the financial performance of NHS bodies in Scotland, it includes the write-off of NHS Argyll and Clyde's cumulative deficit of £81.7 million during 2005/06. When NHS Argyll and Clyde is excluded, the total cumulative underspend for the remaining 23 NHS bodies increased by £4.9 million to £69 million from 2004/05 to 2005/06 (Exhibit 7 overleaf).

Two NHS boards overspent their revenue resource limit

46. Thirteen NHS boards achieved their RRL target (including NHS Argyll and Clyde), with a combined underspend of £56.3 million (11 boards and a £69.7 million underspend in 2004/05).

47. NHS Lanarkshire and NHS Western Isles overspent against their RRL, with a combined cumulative deficit of £10.9 million. The same two boards also overspent against their RRL in 2004/05 with a combined cumulative deficit of £20.8 million.[15]

48. NHS Lanarkshire reduced its cumulative deficit from £20 million in 2004/05 to £8.4 million in 2005/06 by achieving an in-year surplus of £11.6 million. It did not achieve the level of recurring savings it had planned and relied on non-recurring funding and capital to revenue transfers totalling over £21 million to support its financial

15 The Auditor General prepared reports on the 2005/06 annual accounts of NHS Lanarkshire and NHS Western Isles under Section 22 of the Public Finance and Accountability (Scotland) Act 2000. The Section 22 reports can be downloaded from www.audit-scotland.gov.uk

Exhibit 6

RRL outturns for NHS boards and special boards (including NHS Argyll and Clyde), 2005/06

The total cumulative underspend for all NHS bodies, including NHS Argyll and Clyde, is £69.596 million in 2005/06, an increase of almost £65 million on the position reported in 2004/05 (£4.606 million).

	RRL £ million	Outturn £ million	Cumulative underspend/ (overspend) £ million	Cumulative underspend/ (overspend) £ million
	2005/06	2005/06	2005/06	2004/05
NHS boards	7,184.359	7,138.916	45.443	(21.312)
Special boards	905.987	881.834	24.153	25.918
Total	8,090.346	8,020.75	69.596	4.606

Source: NHS audited annual accounts 2005/06

Exhibit 7

RRL outturns for NHS boards and special boards (excluding NHS Argyll and Clyde), 2005/06

The total cumulative underspend of NHS bodies, excluding NHS Argyll and Clyde, is £69.027 million in 2005/06, an increase of almost £5 million on the position reported in 2004/05 (£64.098 million).

	RRL £ million	Outturn £ million	Cumulative underspend/ (overspend) £ million	Cumulative underspend/ (overspend) £ million
	2005/06	2005/06	2005/06	2004/05
NHS boards	6,568.307	6,523.433	44.874	38.180
Special boards	905.987	881.834	24.153	25.918
Total	7,474.294	7,405.267	69.027	64.098

Source: NHS audited annual accounts 2005/06

position in 2005/06. NHS Lanarkshire anticipates that it will clear the rest of its cumulative deficit through the sale of surplus land at the former Law Hospital, subject to the approval of planning permission. The board has recognised that it needs to take further action to achieve recurring savings that will help it move towards financial balance.

49. NHS Western Isles began 2005/06 with a cumulative deficit of £738,000. Half way through 2005/06, the board predicted a year-end cumulative deficit of £2.038 million. However, reliable draft budgets were only available from the end of September 2005, when it became apparent that the projected outturn was likely to be worse than initially forecast. The final position at 31 March 2006 was a cumulative deficit totalling £2.484 million. The board's financial recovery plan does not show NHS Western Isles returning to a surplus position until 2008/09. Further comment on NHS Western Isles is included in Case Study 3 (page 25).

NHS Grampian reported a cumulative deficit in 2004/05 but achieved financial balance in 2005/06

50. NHS Grampian had a cumulative deficit of £10.8 million at the beginning of the year and the board's financial recovery plan anticipated that the deficit would be reduced to £2.7 million at the end of 2005/06. The board actually achieved a £0.4 million surplus against its RRL target for 2005/06 largely due to an earlier than expected sale of property surplus to requirements. This allowed the board to repay all of its cumulative deficit a year ahead of schedule.

51. Although NHS Grampian has achieved financial balance in 2005/06, the board is going into 2006/07 with a recurring funding gap of £21.4 million. NHS Grampian will continue to rely on non-recurring income to support its financial position, although it expects to reduce its reliance on non-recurring funding over the next few years. The auditor has commented on a number of challenges for the board to remain in financial balance, including Agenda for Change.

The overall increase in surpluses against RRL targets rose by almost £7 million for NHS boards

52. Exhibit 8 (page 15) shows that between 2004/05 and 2005/06:

- three boards increased their cumulative surplus (NHS Dumfries and Galloway, NHS Greater Glasgow and NHS Shetland)
- eight boards reduced their cumulative surplus (NHS Ayrshire and Arran, NHS Borders, NHS Fife, NHS Forth Valley, NHS Highland, NHS Lothian, NHS Orkney and NHS Tayside)
- one board increased its cumulative deficit (NHS Western Isles)
- one board decreased its cumulative deficit (NHS Lanarkshire)
- one board moved from a cumulative deficit to a cumulative surplus position (NHS Grampian).

53. The £6.7 million overall increase in surpluses against RRL targets is mainly due to a combination of:

- an increased cumulative surplus at NHS Dumfries and Galloway
- NHS Lanarkshire reducing its cumulative deficit
- NHS Grampian eliminating its cumulative deficit and moving to a cumulative surplus.

54. The auditor for NHS Ayrshire and Arran reported in 2004/05 that the board had a high cumulative surplus because of slippage in planned expenditure against a number of earmarked allocations. At the beginning of 2005/06 the board planned to reduce its cumulative surplus of £22.9 milion to £9.3 million by the end of 2005/06. The outturn for 2005/06 was a surplus of £17.4 million, but the auditor reported that only £4.4 million related to surpluses brought forward from 2004/05. NHS Ayrshire and Arran received a further £13 million in allocations from the SEHD which contributed to the final surplus for 2005/06. The board's five-year financial plan shows that the surplus in 2005/06 will be reduced to £5 million by 2007/08, but the auditor expressed concerns over the board's ability to achieve these forecasts.

55. NHS Dumfries and Galloway had also planned to reduce its £9.4 million cumulative surplus from 2004/05 to £4.1 million by the end of 2005/06. The board had a cumulative surplus of £14.2 million at the end of 2005/06. This higher than planned surplus was due to the board receiving a number of additional allocations from the SEHD during the year totalling £9 million. A number of the additional allocations were larger than the board expected and plans were not in place to use the remaining additional funding.

All special boards achieved their revenue resource limit targets

56. The special boards had a surplus against their RRL targets of £24.2 million (Exhibit 7, page 12). Details of performance against financial targets for all NHS boards and special boards are given in Appendix 1 (page 27).

NHS Argyll and Clyde received an additional £82.3 million to write off its cumulative deficit

57. The Health Minister announced in May 2005 that, following a period of public consultation, NHS Argyll and Clyde would be dissolved on 31 March 2006; its services taken over by NHS Greater Glasgow and NHS Highland; and funds made available to clear its cumulative deficit.[16]

58. The SEHD allocated additional funding of £82.3 million to NHS Argyll and Clyde to clear its cumulative deficit at 31 March 2006. The board reported a surplus of £0.6 million for 2005/06 (against a £59.5 million deficit in 2004/05).

59. Case study 1 provides further information on NHS Argyll and Clyde's financial performance in 2005/06.

60. NHS Argyll and Clyde operated with an estimated underlying deficit of £28.4 million which was inherited by the two successor boards upon its dissolution. Responsibility for the Clyde area went to NHS Greater Glasgow (subsequently renamed NHS Greater Glasgow and Clyde) while NHS Highland assumed responsibility for the Argyll and Bute area. The split of funding and expenditure between the Clyde and Argyll and Bute elements of NHS Argyll and Clyde was reviewed by the successor boards. The review also included estimates for recharge costs which reflect the agreed split of management responsibilities between the boards and anticipated service level agreements. As the underlying deficit was attributed to the Clyde area on dissolution, NHS Greater Glasgow and Clyde inherited it.

61. NHS Greater Glasgow and Clyde has prepared a financial plan which provides for the Clyde element to be monitored as a discrete element of the overall plan. A cost savings plan, due to be completed by January 2007, is also being developed and aims to address the funding plan. NHS Greater Glasgow and Clyde is working with the SEHD to identify how the necessary additional funding to bridge the underlying deficit will be sourced.

Achieving financial balance

62. Previous overview reports have highlighted how NHS bodies achieved their RRL targets by using non-recurring funding and making non-recurring savings which do not reduce the operating cost base. This continues to be the case and this part of our report discusses:

- financial gaps occurring in 2005/06 (this is a gap between expected recurring income and expenditure at the beginning of the financial year)
- how NHS bodies used non-recurring funding to support their financial position in 2005/06
- using efficiency savings to achieve financial plans and the ability of boards to monitor and report on savings required by the Efficient Government Initiative.

Twelve NHS bodies had spending plans which exceeded available recurring funding

63. In 2005/06, ten NHS boards had gaps totalling £147.4 million, with five boards accounting for £131 million of this (Exhibit 9, page 16).[17] Two special boards had gaps in 2005/06: NHS Education Scotland (£7.2 million) and the Scottish Ambulance Service Board (£2.2 million). None of the special boards had gaps in 2004/05.

NHS bodies used non-recurring funding to reduce financial gaps in 2005/06

64. We have commented in previous overview reports that NHS bodies rely on non-recurring funding to achieve financial targets or support their financial position. Non-recurring funding is a normal part of running the NHS in Scotland but it should not be used to excess or for sustaining day-to-day activities in the long-term. Non-recurring measures can include support from the SEHD (such as an additional RRL allocation), proceeds from the sale of assets and capital to revenue transfers. Twelve NHS bodies with gaps in 2005/06 identified almost £197 million to reduce or eliminate gaps, 80 per cent of which was non-recurring (Exhibit 9, page 16).

65. HM Treasury rules mean that NHS bodies will no longer be able to transfer funding from capital to revenue after 2005/06. Auditors of three boards (NHS Forth Valley, NHS Lanarkshire and NHS Lothian) have identified the withdrawal of capital to revenue transfers as a major risk to the achievement of their financial plans. These boards have set challenging savings targets for 2006/07 to offset the loss of this source of non-recurring funding. Any NHS bodies that have relied on this source of funding to break even will now need to make additional savings.

66. Auditors for five NHS boards commented on reliance on capital to revenue transfers, totalling £44.8 million: NHS Fife (£2.4 million); NHS Highland (£4.2 million); NHS Lanarkshire (£17.8 million); NHS Lothian (£19.6 million);

16 Statement to the Scottish Parliament by the Minister for Health and Community Care, May 2005.
17 NHS Grampian, NHS Highland, NHS Lanarkshire, NHS Lothian and NHS Tayside.

Exhibit 8

Financial performance of NHS boards in 2005/06 compared to 2004/05 (excluding NHS Argyll and Clyde)

The £6.7 million overall increase in surpluses was mainly due to slippage against planned expenditure and boards receiving non recurring income.

NHS board	Cumulative outturn underspend/(overspend) 2004/05 £ million	Cumulative outturn underspend/(overspend) 2005/06 £ million
NHS Ayrshire and Arran	22.901	17.405
NHS Borders	3.380	3.314
NHS Dumfries and Galloway	9.455	14.223
NHS Fife	5.400	4.582
NHS Forth Valley	0.410	0.407
NHS Grampian	(10.774)	0.456
NHS Greater Glasgow	12.103	12.284
NHS Highland	1.838	1.369
NHS Lanarkshire	(20.042)	(8.393)
NHS Lothian	9.703	0.179
NHS Orkney	0.060	0.050
NHS Shetland	0.024	0.341
NHS Tayside	4.460	1.141
NHS Western Isles	(0.738)	(2.484)
Total	38.180	44.874

Source: NHS audited annual accounts 2005/06

Case study 1

NHS Argyll and Clyde's financial performance in 2005/06

NHS Argyll and Clyde identified a potential in-year deficit of £37 million for 2005/06. The board actually achieved savings of over £14 million and the position for 2005/06 was an in-year deficit of £22.2 million. When this in-year position was combined with the £59.5 million deficit from 2004/05, the cumulative deficit at 31 March 2006 was £81.7 million. The SEHD provided the board with an additional RRL allocation of £82.3 million to write off the deficit. This meant the board reported a surplus of £0.6 million.

Some of the savings that the board had planned to make were expected to come from the non-acute clinical strategy. However, the strategy was not implemented and this has implications for the successor boards' own savings plans and clinical strategies.

Source: Auditor's report on the 2005/06 audit of NHS Argyll and Clyde

Exhibit 9

Measures used by NHS bodies with gaps in 2005/06

Of the £196.8 million used by NHS bodies to eliminate or reduce their gaps, £156.3 million (almost 80%) was non-recurring.

NHS body	Actual gap (2005/06)	Measures to reduce or eliminate gaps between total recurring funding and total expenditure (2005/06)				
		Total measures used	=	Non-recurring measures	+	Recurring savings
	£ million	£ million		£ million		£ million
NHS Fife	5.5	10.1		4.3		5.8
NHS Grampian	19.5	20.0		20.0		0
NHS Greater Glasgow	2.0	14.0		14.0		0
NHS Highland	22.8	24.2		24.2		0
NHS Lanarkshire	19.0	30.6		25.9		4.7
NHS Lothian	56.0	56.0		41.2		14.8
NHS Orkney	2.3	2.3		0.7		1.6
NHS Shetland	2.4	2.7		1.9		0.8
NHS Tayside	13.7	14.9		5.3		9.6
NHS Western Isles	4.2	1.7		0		1.7
Total boards	**147.4**	**176.5**		**137.5**		**39.0**
NHS Education Scotland	7.2	18.2		18.2		0
Scottish Ambulance Service Board	2.2	2.2		0.6		1.5
Total special boards	**9.4**	**20.4**		**18.8**		**1.5**
Total	**156.8**	**196.8**		**156.3**		**40.5**

Source: Financial returns completed by NHS directors of finance (unaudited)

and NHS Shetland (£0.8 million). Case study 2 (page 18) on NHS Lothian highlights the measures it has used to achieve its financial balance in 2005/06 as well as its financial outlook for 2006/07.

67. The overall capital budget for the NHS as a whole was reduced by £120 million to take account of capital to revenue transfers across the whole of the NHS in 2005/06 (paragraph 71).

Current savings targets are challenging

68. NHS bodies reported total savings of £116.4 million in 2005/06 (£115 million in 2004/05) (Exhibit 10, page 19). We have previously reported that some boards experienced difficulties in achieving their savings plans because they were overambitious.[18] Some of the savings plans set by boards for 2006/07 are challenging and represent a significant increase on the level of savings achieved in 2005/06.

69. NHS Tayside's financial plan for 2005/06 set a savings target of £17.5 million. This target was revised to £13.2 million through the use of contingency funds, reductions in capital charges arising from estate revaluations and savings through the pharmaceutical price regulation scheme. The board achieved savings of £11.5 million and the auditor commented that the proportion coming from non-recurring sources was higher than planned.

70. NHS Fife had set a savings target of just over £5 million for 2005/06 but the board reported that it had achieved savings of over £7.6 million. The auditor highlighted concerns about the board's ability to accurately monitor and report savings achieved and that it was unclear as to the scale to which savings targets had been met. The auditor's view is that much of the savings reported by NHS Fife were due to slippage against expenditure or from changes in costs largely outwith the board's control.

All NHS bodies achieved their CRL and cash requirement targets in 2005/06

71. The original overall capital budget of £425 million for the NHS as a whole was reduced by £120 million to take account of capital to revenue transfers authorised by the SEHD during 2005/06. This left a final overall capital budget of £305 million for 2005/06.

72. The total capital expenditure reported for the NHS as a whole in 2005/06 was £234 million, £27 million less than the overall expenditure reported by NHS bodies (£261 million). The SEHD reduced the capital outturn reported to reflect the treatment of £27 million of capital grants as revenue expenditure within the SEHD's consolidation of NHS accounts. NHS bodies are required to treat these grants as capital expenditure for calculation of their outturn against the CRL because grants are recognised as a charge against Treasury capital budgets. Within the Scottish Executive's accounts the grants are treated as revenue expenditure. As a result of these adjustments, the NHS as a whole reported a spend of £234 million against the overall CRL in 2005/06 and therefore had an underspend of £71 million against the revised overall capital budget of £305 million.

73. All NHS bodies achieved their CRL target. They used £261 million of their CRL and had an overall surplus of £14.4 million (£5.5 million for 2004/05) (Exhibit 11, page 20).

74. The overall underspend of £14.4 million reported by NHS bodies against the CRL for 2005/06 was largely due to three NHS boards – NHS Lanarkshire (£3.5 million), NHS Lothian (£5.7 million) and NHS Argyll and Clyde (£1.4 million).

75. NHS Lanarkshire is also planning to underspend against its capital budget in 2006/07 because:

- transfers between capital to revenue are no longer permitted
- two of the board's three main hospitals operate under PFI agreements which means that capital improvements are the responsibility of the contractors
- the board's surplus against its capital budget of £3.5 million will be carried forward and available for use in 2006/07
- the board plans to sell surplus properties and the proceeds from these sales may be available for capital expenditure.

76. NHS Lothian's underspend against its CRL of £5.7 million was a result of the auditor challenging the change in accounting policy for certain consumable items and the accounting treatment of a cash payment relating to the University of Edinburgh Centre for Reproductive Biology (Case study 2, page 18). This meant that a total of £5.7 million of expenditure charged by NHS Lothian against its CRL was subsequently recharged to the RRL.

77. NHS Argyll and Clyde's capital plan for 2005/06 amounted to £24.7 million. However, the board identified early in the year that £8.7 million would not be required due to the timing of specific projects.

Case study 2

Achieving financial balance in NHS Lothian

We have commented on the financial performance of NHS Lothian (and the former Lothian University Hospitals NHS Trust) in overview reports since 2001/02. NHS Lothian has always achieved its financial targets but to date this has included the use of significant levels of non-recurring funding.

Financial measures used by NHS Lothian to achieve its financial targets in 2005/06

NHS Lothian's five-year financial plan and monthly reporting continually forecast that the board would achieve a balanced financial position in 2005/06. The board discovered, late in 2005/06, that Family Health Services (FHS) income had been incorrectly identified and disclosed in 2004/05. This meant that the £19.6 million cumulative surplus brought forward from 2004/05 was reduced by £10 million. NHS Lothian brought this to the attention of the SEHD which agreed that the board could retain this additional RRL. The board used £6 million of the 'surplus' RRL to repay part of the £20 million brokerage it had received from the SEHD in previous years.

NHS Lothian originally identified a gap of almost £50 million between its recurring costs and the recurring income available to the board for 2005/06. The board planned to close this gap by using £25.6 million of non-recurring income and achieving savings totalling £24.3 million. The non-recurring income used by NHS Lothian to achieve its financial target in 2005/06 consisted of capital to revenue transfers (£10 million); prior year surplus (£11 million); capital receipts (£2.6 million); and other income (£2 million).

NHS Lothian met its savings target of £24.1 million, but £9.5 million was on a non-recurring basis. This means that this money must be found again in 2006/07 and subsequent years. NHS Lothian interpreted the new guidance on capital grants in such a way as to treat a cash payment relating to the University of Edinburgh Centre for Reproductive Biology as a capital grant. The board also changed its accounting policy for certain consumable items, such as pacemakers and digital hearing aids, and treated them as fixed assets. The auditor queried the nature of these transactions and NHS Lothian reversed the accounting treatment for both items, but this increased the total revenue gap for 2005/06 to £56 million. The board requested additional funding from the SEHD to cover this unexpected cost and received a late RRL allocation of £5.7 million, which is repayable from future asset sales. Overall, NHS Lothian used non-recurring measures of almost £32 million, plus savings (recurring and non-recurring) totalling a further £24.3 million, to achieve a cumulative surplus of £179,000 in 2005/06.

The final outturn for 2005/06 varied during the audit process

During 2005/06, NHS Lothian reported its expectation of a break-even financial position at 31 March 2006 to the board, the finance and performance review committee, and the SEHD. The outturn for 2005/06 was reported to the finance and performance review committee as all targets having been met, subject to audit. However, NHS Lothian had to make a significant number of changes to the draft accounts to address issues identified during the 2005/06 audit. The auditor reported that the nature and value of the changes between reported positions and final financial statements this year, and in previous years, introduces a level of unnecessary volatility and risk into NHS Lothian's overall financial position. The auditor has recommended that NHS Lothian review its financial recording processes, particularly at the acute operating division.

The outlook for NHS Lothian in 2006/07

NHS Lothian's five-year financial plan forecasts that the board will break even in 2006/07 after taking account of £8.5 million of non-recurring funding and planned savings of £31 million. The auditor's view is that this savings target will be extremely demanding.

The board has failed to address previously reported weaknesses in financial control

The auditor's work on systems and controls found important areas where basic internal controls were, in the auditor's view, absent or not operating as intended, including significant issues relating to access to the financial ledgers. The auditor reported that these issues posed an increased risk of fraud, error and subsequent misstatement and had been raised as weaknesses in previous years. The auditor also encountered a number of other problems during the audit, which stemmed from the board's failure to address previously reported limitations in operational systems.

Source: Auditor's report on the 2005/06 audit of NHS Lothian

Exhibit 10
Savings in 2005/06

NHS bodies made total savings of £116.4 million in 2005/06 (recurring and non-recurring).

	Savings £ million
NHS Argyll and Clyde	14.4
NHS Ayrshire and Arran	4.6
NHS Borders	2.0
NHS Dumfries and Galloway	1.6
NHS Fife	7.6
NHS Forth Valley	4.7
NHS Grampian	10.9
NHS Greater Glasgow	10.0
NHS Highland	8.0
NHS Lanarkshire	8.9
NHS Lothian	24.3
NHS Orkney	1.6
NHS Shetland	1.3
NHS Tayside	11.5
NHS Western Isles	1.7
Total NHS boards	**113.1**
The National Waiting Times Centre Board	0.5
NHS Education Scotland	0.4
Scottish Ambulance Service Board	1.5
State Hospitals Board for Scotland	0.9
Total special boards	**3.3**
Total NHS bodies	**116.4**

Source: Financial returns prepared by NHS directors of finance (unaudited)

Exhibit 11

Performance of NHS bodies against CRL target, 2004/05 and 2005/06

	CRL 2005/06 £ million	Outturn 2005/06 £ million	CRL underspend/ (overspend) 2005/06 £ million	CRL underspend/ (overspend) 2004/05 £ million
NHS boards	232.089	219.942	12.147	4.458
NHS special boards	43.146	40.862	2.284	1.034
Total	275.235	260.804	14.431	5.492

Source: NHS audited annual accounts 2005/06

An agreement was reached with the SEHD to return this surplus capital funding for carry forward into 2006/07. The board actually spent £14.6 million against the revised CRL, resulting in a £1.4 million underspend. The reason for the slippage against the capital plan is that the majority of projects included in the plan were to support the NHS Argyll and Clyde Clinical Strategy, but were delayed pending the board's dissolution. Decisions about the future provision of services, and related capital projects, are now the responsibility of the successor boards, NHS Greater Glasgow and Clyde and NHS Highland.

78. It is likely that underspends against capital budgets will continue to occur for two main reasons:

- capital to revenue transfers are no longer allowed so boards may find it difficult to spend their capital allocations
- capital projects have an impact on the revenue outturn as well because of the cost of capital and depreciation they attract, and the lifecycle and maintenance costs incurred. There is therefore a risk that boards may continue to underspend on their capital budgets to avoid the revenue implications associated with capital projects.

79. NHS bodies will need to consider how to use the current underspend against capital budgets, and support effective use of capital budgets in the future.

The NHS in Scotland is expected to contribute to the Efficient Government Initiative by making £523 million savings by 2007/08

80. The Scottish Executive launched its Efficient Government Initiative, *Building a Better Scotland*, in June 2004. Its latest technical note shows that it expects the NHS in Scotland to deliver £349.9 million cash-releasing savings and a further £173 million time-releasing savings by 2007/08, a total of £523 million.[19]

81. Audit Scotland commented on the Scottish Executive's Efficiency Technical Notes in May 2005 (cash-releasing savings) and August 2005 (time-releasing savings).[20] We will publish a progress report on the Efficient Government Initiative in December 2006. This report looks in more detail at the information underpinning reported savings for the NHS.

82. Examples of efficiency gains reported by the NHS through cash-releasing activities during 2005/06 include:

- £71 million of efficiency savings against a target of £88 million. The target represents a recurring one per cent efficiency saving which NHS bodies are expected to make each year.

19 *Scottish Executive Efficiency Technical Notes*, Scottish Executive, March 2006.
20 Audit Scotland, May 2005 and August 2005.

- £38 million of savings from national arrangements for the pricing of drugs arising from the Pharmaceutical Prices Regulation Scheme. This scheme was negotiated on a UK-wide basis with suppliers of drugs. The target has been derived by applying a seven per cent discount across all branded drugs. The target for the year was £42 million.

- £21.6 million from improved drug prescribing including the use of generic medicines, a reduction in inappropriate prescribing and a switch away from branded drugs when patents expire. This is against a target of £5 million. A previous Audit Scotland report in 2003 highlighted the potential to make savings in this area.[21]

- £33.3 million savings from procurement against a savings target of £33 million. These savings are based on reduced prices for equipment and services negotiated as part of national contracts. It includes savings in the procurement of medical locums, drugs, food and IT hardware.

83. In addition, some of the savings identified by the Scottish Executive are expected to come from national initiatives, such as the National Shared Support Services (NSSS) project. This project is designed to provide the NHS in Scotland with a single shared service for day-to-day financial transactions and planned to deliver £10 million savings annually from 2007/08. However, the auditor for NHS National Services Scotland has reported that estimates of recurring savings have been downgraded. This is because many boards have already made savings through the move to single system working and the SEHD now expects a reduced level of savings from the NSSS project.[22]

84. The NHS has reported less success to date in achieving savings from time-releasing activities. It aimed to achieve £22 million in 2005/06, £46.5 million in 2006/07 and £73.9 million in 2007/08 from improved consultant productivity, but reports no savings for 2005/06. Audit Scotland's report on the consultant contract highlighted the difficulty of achieving this as many consultants are working over their contracted hours.[23] This target will remain a challenge for the NHS.

85. The NHS also aimed to achieve £16.3 million savings in reducing sickness absence but has reported a saving of £5.8 million against this target in 2005/06.

Single system working provides opportunities for better financial management

86. The move to single system working has provided NHS boards with an opportunity to harmonise budget setting and control, and integrate financial systems. Auditors report that financial management arrangements are good at NHS Ayrshire and Arran, NHS Borders and NHS Forth Valley. Following its planned transitional period, NHS Greater Glasgow has made progress in financial planning, control and monitoring, and further work is underway around the format of financial reports to the board and its divisions.

87. All NHS bodies received an unqualified opinion on the truth and fairness of their annual accounts, except NHS Highland where the auditor disagreed with the accounting treatment adopted by the board for two PFI agreements. The Auditor General prepared a Section 22 report on this issue.[24]

88. Auditors have highlighted a number of weaknesses in financial management and overall financial control which shows that some boards have still to make further improvements (Exhibit 12 overleaf).

The SEHD is monitoring the financial position of NHS bodies

89. The SEHD currently monitors the financial position of NHS boards through monthly returns prepared by each board. We have highlighted how the SEHD has started to restructure its finance function and the department is in the process of establishing revised monitoring arrangements for Departmental expenditure and expenditure incurred by NHS bodies (paragraph 42, page 10).

21 *Supporting prescribing in general practice*, Audit Scotland, 2003.
22 *Scottish Executive Progress Report on Audit Committee Recommendations AU/S2/06/13/5*, Scottish Parliament Audit Committee, September 2006.
23 *Implementing the NHS consultant contract in Scotland*, Audit Scotland, 2006.
24 Prepared under Section 22 of the Public Finance and Accountability (Scotland) Act 2000. A copy of the Section 22 report on NHS Highland can be viewed at www.audit-scotland.gov.uk

Exhibit 12

Financial management arrangements across NHS boards in Scotland

- NHS Fife has made improvements in budgetary control arrangements and there has been further development of financial operating procedures and standing financial instructions which better reflect single system working. But the board needs greater clarity as to the underlying financial position on recurring and non-recurring income and expenditure.
- The head of financial planning at NHS Highland highlighted the board's reliance on non-recurring income in April 2005. Work is ongoing at NHS Highland to develop a revised financial model to address this issue, but this is not yet completed.
- Previous audit reports on NHS Lanarkshire have highlighted a number of weaknesses within financial planning, budgetary control and financial reporting arrangements. The auditor highlighted that the board's achievement of an in-year surplus and the accuracy of forecasts demonstrates better budgetary control and reporting during the year. However, there are still differences in budget setting at a divisional level and work is ongoing to develop common principles and approaches.
- NHS Orkney's financial reports to the board do not always highlight key financial movements and developments, which can make the reports difficult to understand.
- NHS Western Isles had strengthened its financial and accounting controls by the end of the year. However, the board did not have reliable or robust budgetary information until September 2005. The board's internal auditors also highlighted that the board did not have a satisfactory set of internal controls in place throughout 2005/06.

Source: Auditors' reports on 2005/06 audits

Part 3. Governance

Key message

Most boards are making progress in setting up structures and governance arrangements to support single system working but the transition has been more challenging for some of the larger NHS boards. Governance arrangements for the new CHPs are at an early stage.

There have been a number of major changes affecting the structure of the NHS in Scotland

90. The structure of the NHS has changed significantly over the last three years including:

- the dissolution of NHS trusts and the formation of 15 unified boards (now 14 with the dissolution of NHS Argyll and Clyde)
- the establishment of CHPs.

91. Change looks set to continue as the NHS in Scotland moves toward a system which puts more emphasis on improving health and targeting resources on those at greatest risk in line with the aims of *Delivering for Health*. Good governance arrangements are essential at a time of structural change to ensure that internal controls operate as intended, risks are identified and managed, and key staff members are retained.

The move to single system working has been a challenge for some of the larger boards

92. We reported last year that some boards were operating interim corporate governance arrangements for part of 2004/05. Auditors reported that further progress has been made in 2005/06 although the transition to single system working is taking longer for some of the larger NHS boards.

93. NHS Lanarkshire continued to embed single system working during 2005/06 but recognises that further work is required on budget setting and risk management arrangements.

94. NHS Greater Glasgow, given the size and complexity of the board, decided to adopt a two-year approach to implementing single system working. This has involved the dissolution of individual divisions, the creation of one Greater Glasgow-wide board and establishing a complex network of Community Health and Care Partnerships (CHCPs) and CHPs (Exhibit 13 overleaf). Further work has been undertaken in 2005/06 including the establishment of single system committees. However, the transfer of services from the former NHS Argyll and Clyde will mean further work is required in the new NHS Greater Glasgow and Clyde, particularly on the board's risk management strategy and protocols.

95. NHS Lothian implemented the second phase of its restructuring in April 2005, creating the operating division responsible for delivering acute services and a primary care organisation (including four CHPs and one CHCP). The board's Statement of Internal Control for 2005/06 shows that further action is required before NHS Lothian is operating as a single system. Work planned for 2006/07 includes implementing:

Exhibit 13

NHS Greater Glasgow and Clyde CHPs and CHCPs

NHS Greater Glasgow and Clyde has responsibility for six CHCPs and four CHPs, and an involvement with two CHPs which are the responsibility of NHS Lanarkshire.

Location	Name	Type	Bodies involved
1	North Glasgow	CHCP	NHS Greater Glasgow & Clyde, Glasgow City Council
2	East Glasgow	CHCP	NHS Greater Glasgow & Clyde, Glasgow City Council
3	West Glasgow	CHCP	NHS Greater Glasgow & Clyde, Glasgow City Council
4	South East Glasgow	CHCP	NHS Greater Glasgow & Clyde, Glasgow City Council
5	South West Glasgow	CHCP	NHS Greater Glasgow & Clyde, Glasgow City Council
6	East Renfrewshire	CHCP	NHS Greater Glasgow & Clyde, East Renfrewshire Council
7	East Dunbartonshire	CHP	NHS Greater Glasgow & Clyde, East Dunbartonshire Council
8	West Dunbartonshire	CHP	NHS Greater Glasgow & Clyde, West Dunbartonshire Council
9	Renfrewshire	CHP	NHS Greater Glasgow & Clyde, Renfrewshire Council
10	Inverclyde[25]	CHP	NHS Greater Glasgow & Clyde, Inverclyde Council

Source: NHS Greater Glasgow and Clyde Community Health Partnership website (http://www.chps.org.uk)

25 The CHP in Inverclyde is not yet established.

Case study 3

Governance arrangements in NHS Western Isles during 2005/06

In 2003/04, the auditor for NHS Western Isles identified a number or areas for improvement in its corporate governance arrangements. The board implemented a revised corporate governance framework in 2004/05. But the auditor identified further weaknesses in the 2004/05 final audit report.

The auditor has reported some improvements in the board's corporate governance arrangements in 2005/06, including the development of a risk management strategy and a risk management action plan. A number of new non-executive members took up post in 2005/06 and committees now meet on a more regular basis. The board did not have a complete set of internal controls in place throughout 2005/06. The internal auditors made a number of recommendations and the board is currently addressing these issues.

NHS Western Isles has also experienced difficulties in establishing its single CHP, despite assistance from the Joint Improvement Team. The difficulties have centred on the board reaching an agreement on the way forward with its key partner, Comhairle nan Eilean Siar. This meant that the board was unable to prepare a Scheme of Establishment for its CHP by the revised deadline of 31 March 2006.

The chair resigned in August 2006 and the Minister for Health and Community Care appointed an interim chair in his place. As part of a planned recovery programme, a senior managerial and clinical team, drawn from other NHS boards and the SEHD, was put in place to support the interim chair.

Source: Auditor's report on the 2005/06 audit of NHS Western Isles

- a single financial system, completion of outstanding financial operating procedures and harmonisation of risk assessment procedures
- systems to provide reliable access to patient case notes
- a board-wide human resource system, including processes to monitor compliance with the EU working time directive
- comprehensive emergency plans.

96. The island boards have always operated as single systems but we have highlighted concerns for the last two years about corporate governance in NHS Western Isles. The auditor reported that some progress has been made in this area in 2005/06 but that the board still continues to have problems in establishing robust corporate governance arrangements (Case study 3). The auditor will continue to monitor the board's governance arrangements during 2006/07.

Most CHPs are now established and developing their governance arrangements

97. CHPs in most boards were operational by April 2006 and are anticipated to play a critical role in reshaping health services in Scotland. However, the establishment of CHPs in some boards has been delayed.

98. NHS Argyll and Clyde did not implement its CHPs as planned. Ministers did not approve the five proposed schemes of establishment prior to the decision to dissolve the board and only limited progress was made during 2005/06. Responsibility for developing CHPs in the former NHS Argyll and Clyde area has now transferred to NHS Greater Glasgow and Clyde and NHS Highland.

99. NHS Orkney and NHS Western Isles had not implemented CHPs by April 2006. The scheme of establishment for Orkney CHP was approved in November 2006.

Governance arrangements in CHPs are still developing

100. NHS boards are devolving key areas of responsibility to their CHPs. Critical to this is the need for sound governance arrangements to support CHPs in doing the job expected of them, and to ensure that they use resources properly and to good effect.

101. Auditors have reported that, where CHPs have been established, governance arrangements are in place but these are at an early stage. Further work needs to be done in a number of governance areas including schemes of delegation (NHS Greater Glasgow); shared objectives and reporting arrangements (NHS Lanarkshire); and accountability arrangements (NHS Grampian).

Boards are making good progress in developing clinical governance and risk management arrangements

102. We drew attention last year to NHS Quality Improvement Scotland's (NHS QIS) interim review of boards' clinical governance and risk management arrangements.[26] NHS QIS reported that boards were making good progress in developing structures and implementing processes to ensure that clinical governance and clinical risk management are embedded in single system working.

103. NHS QIS has now issued standards on clinical governance and risk management. One of the first boards reviewed by NHS QIS in 2006 was NHS Borders.[27] The review identified a number of examples of good practice including NHS Borders' interaction with the public, carers and its joint working arrangements with Scottish Borders Council. The review also highlighted a number of issues for the board to address including business continuity arrangements, reporting arrangements and processes for approving and finalising strategies prior to implementation.

104. Auditors for most other boards have provided high level commentary on clinical governance and risk management arrangements in their final audit reports because NHS QIS is currently reviewing the rest of the boards. Where auditors have commented, it appears that boards are continuing to make progress in this area.[28]

105. Auditors are working with NHS QIS to share intelligence on boards' governance and risk management arrangements. NHS QIS intends to publish a national report on clinical governance and risk management in November 2007. We will comment on this in the NHS overview report for 2006/07.

26 *Safe and Effective Care: Interim Review of Clinical Governance and Risk Management Arrangements in NHSScotland*, NHS QIS, June 2005.
27 Auditor's report on the 2005/06 audit of NHS Borders.
28 NHS Ayrshire & Arran, NHS Dumfries & Galloway, NHS Forth Valley, NHS Grampian, NHS Greater Glasgow, NHS Orkney, NHS Tayside, NHS Western Isles.

Appendix 1. Financial performance of NHS bodies 2005/06

NHS boards	Revenue resource limit £ million	Revenue resource outturn £ million	Variance under/ (over) £ million	Capital resource limit £ million	Capital resource outturn £ million	Variance under/ (over) £ million
NHS Argyll and Clyde	616.052	615.483	0.569	15.963	14.542	1.421
NHS Ayrshire & Arran	549.019	531.614	17.405	22.374	21.778	0.596
NHS Borders	157.135	153.821	3.314	5.147	5.142	0.005
NHS Dumfries & Galloway	232.160	217.937	14.223	8.305	8.298	0.007
NHS Fife	462.830	458.248	4.582	9.885	9.789	0.096
NHS Forth Valley	377.451	377.044	0.407	11.840	11.799	0.041
NHS Grampian	652.074	651.618	0.456	10.468	10.468	0.000
NHS Greater Glasgow	1370.302	1358.018	12.284	69.460	69.337	0.123
NHS Highland	330.747	329.378	1.369	11.900	11.794	0.106
NHS Lanarkshire	723.298	731.691	(8.393)	14.212	10.739	3.473
NHS Lothian	1005.644	1005.465	0.179	33.072	27.347	5.725
NHS Orkney	35.137	35.087	0.050	2.563	2.440	0.123
NHS Shetland	38.029	37.688	0.341	2.733	2.436	0.297
NHS Tayside	577.150	576.009	1.141	11.695	11.689	0.006
NHS Western Isles	57.331	59.815	(2.484)	2.472	2.344	0.128
Total for NHS boards	**7184.359**	**7138.916**	**45.443**	**232.089**	**219.942**	**12.147**
NHS special boards						
NHS National Services Scotland	263.340	258.263	5.077	21.880	21.878	0.002
Mental Welfare Commission for Scotland	3.586	3.526	0.060	0.423	0.422	0.001
The National Waiting Times Centre Board	38.094	34.103	3.991	3.790	3.396	0.394
NHS 24	51.501	50.692	0.809	4.409	2.524	1.885
NHS Education for Scotland	326.993	316.033	10.960	0.188	0.188	0.000
NHS Health Scotland	19.672	19.545	0.127	0.033	0.033	0.000
NHS Quality Improvement Scotland	14.740	14.472	0.268	0.044	0.044	0.000
Scottish Ambulance Service Board	154.102	154.101	0.001	10.277	10.275	0.002
State Hospitals Board for Scotland	33.959	31.099	2.860	2.102	2.102	0.000
Total for special boards	**905.987**	**881.834**	**24.153**	**43.146**	**40.862**	**2.284**
Total for all NHS bodies	**8090.346**	**8020.750**	**69.596**	**275.235**	**260.804**	**14.431**

Appendix 2. Glossary of terms

Accelerated depreciation	Where a board has approved a decision to close a property and where the asset's value in use is greater than its alternative use value, the asset must be written down to its net realisable value over the estimated remaining life of the asset. The resulting increase in the annual depreciation charge is known as accelerated depreciation.
Agenda for Change	A UK-wide plan to introduce a new pay system for all NHS staff with the exception of doctors, dentists and most senior managers. The new system aims to standardise conditions of service for staff.
Annual accounts	The annual accounts of an NHS body provide the financial position for a financial year ie, 1 April to 31 March. The format of the annual accounts is set out in NHS accounts manuals and includes financial statement, notes to the accounts and memorandum statements (known as Scottish Financial Returns).
Audit report	A final report by an NHS body's auditor on the findings from the audit process.
Break even	Where income equals expenditure.
Brokerage	Brokerage was introduced in January 2003 and enabled NHS bodies to obtain advance funding from a 'bank' established from surplus funds not required by other NHS bodies. The scheme was withdrawn in September 2003 to be replaced by repayable advances in allocations.
Capital charges	The revenue costs associated with fixed assets. This includes elements of depreciation and interest.
Capital grants	Payments by boards for securing or improving assets which will benefit the board, or its resident population, even though the assets will not be owned by the board.
Capital receipts	Funding received from the sale of capital items (items with a value greater than £5,000) including land, buildings and equipment.
Capital resource limit (CRL)	The amount of money an NHS board is allocated to spend on capital schemes in any one financial year.
Capital to revenue transfer	Funding transferred from use on capital spending (i.e. items over £5,000) to be used on revenue, or day to day expenditure. This may or may not be associated with a particular capital scheme. Capital to revenue transfers ceased from 2006/07.
Cash releasing savings	Where a saving is realised because the organisation or function delivers the same service with less money. For example, by delivering support services differently.
Cash requirement	This is the amount of cash an NHS body needs to support its operational activities during the year.
Central unallocated provision (CUP)	A central 'bank' at the Scottish Executive where departments can place surplus funds which are not immediately required. Departments are able to draw down any provision held in the CUP, if there is a strong business case for the additional funding.
Clinical governance	Arrangements put in place to ensure safe and effective healthcare.
Community Health Partnership (CHP)	A partnership between health and social care and responsible for the delivery of a wide range of community health provision including GP services, pharmacy, social care and community nursing.
Community Health and Care Partnership (CHCP)	A partnership between health and social care and responsible for the delivery of a wide range of community health provision including GP services, pharmacy, social care and community nursing. Also responsible for many local social care services, provided by social work staff.

Consolidation	Where a group of entities combine (consolidate) their financial statements into one set of accounts. The Scottish Executive's consolidated accounts reflect the consolidated assets and liabilities and the results of all entities within the Scottish Executive departmental accounting boundary.
Consultant contract	The new pay, terms and conditions negotiated on a UK-wide basis for NHS consultants.
Corporate governance	Arrangements put in place to ensure proper use of management and resources.
Cross-boundary patient flows	Patients treated in an NHS board area other than their resident board.
Cumulative deficit	The excess of expenditure over income built up over more than one year.
Cumulative surplus	The excess of income over expenditure built up over more than one year.
Efficient Government Initiative	A Scottish Executive initiative to increase efficiency across the whole of the public sector in Scotland by delivering the same services with less money or delivering more services with the same money.
Executive agency	Agencies are established by ministers as part of Scottish Executive departments, or as departments in their own right, to carry out a discrete area of work. Agencies are staffed by civil servants.
Family Health Services (FHS)	Services provided by GPs, dentists, opticians and community pharmacists.
Financial balance	Where income received is equal to expenditure made on an ongoing basis.
Financial gap	The difference between the income and expenditure that is needed on a recurring basis to pay for operational activities. This excludes any additional one-off funding received from SEHD and any planned savings.
Financial statements	The main statements in annual accounts of an NHS body. These include: an operating cost statement, statement of recognised gains and losses, balance sheet and cash flow statement. The format of these statements is specified in NHS accounts manuals.
Financial stewardship	Financial stewardship ensures that expenditure is properly incurred and authorised. Proper accounting records are maintained and financial statements are prepared in line with standard accounting practice and relevant guidance.
GMS contract	A new contract for general practitioners (GPs) introduced in April 2004 where GPs receive a lump sum based on a contract. Additional payments are made for services provided over and above those specified in the contract or where they are provided to an enhanced specification.
Governance	The framework of accountability to users, stakeholders and the wider community, within which the organisations take decisions, and lead and control their functions, to achieve their objectives.
In-year financial performance	Result of income compared with expenditure, ignoring any impact of the previous years' financial results.
Joint Improvement Team	A team within the Scottish Executive whose main aim is to provide practical support and additional capacity to joint future partnerships faced with particular issues.
Non-recurring funds	An allocation of funding for projects with a specific life span, or one-off receipts. This includes ring-fenced funding, capital receipts and capital to revenue transfers.

One-off funding	Funding which is provided for one year only.
Operational cost base	The cost of providing day-to-day healthcare services in an NHS board area.
Outturn	The final financial position, which could be the actual or forecast position.
Private Finance Initiative (PFI)	The UK Government's initiative to encourage the development of private finance in the public sector. A generic term for projects involving both the public and private sectors. The involvement can be to varying degrees and the partnership can take different forms.
Qualified audit opinion	When an auditor is of the opinion that there is a problem with the annual accounts of an NHS body, they can issue a qualified report on the accounts. The qualification may be on the truth and fairness of the accounts, the regularity of transactions or both.
Regularity opinion	Auditors provide an opinion as to whether an NHS body's transactions throughout the year are regular ie, they are in accordance with relevant legislation and guidance issued by Scottish ministers.
Resource accounting and budgeting	Accruals accounting for government, which plans, controls and analyses expenditure by departmental objectives.
Revenue resource limit (RRL)	The amount of money an NHS board is allocated to spend on day-to-day operations in any one financial year.
Section 22 report	Reports produced by the Auditor General for Scotland to draw attention to significant issues concerning the accounts of public sector bodies. Section 22 reports are only produced for bodies where the Auditor General for Scotland is responsible for securing the audit.
Tariff	A national price list for hospital procedures carried out by one board on behalf of patients who reside in another board area. The national tariff is intended to simplify the process for service level agreements between boards for cross-boundary activity.
Time-releasing savings	Efficiencies which do not release cash but allow frontline services to deliver more or better services with the same money. For example, through reducing sickness absence.
True and fair opinion	Auditors provide an opinion as to whether an NHS body's accounts have been prepared in accordance with all relevant accounting standards, legislation and guidance.
Underlying deficit	The underlying deficit is the on-going financial gap in the NHS board area between the money received to provide health services and the costs of providing these services.
Unqualified audit opinion	When auditors of NHS bodies are satisfied with the annual accounts they will issue an unqualified audit opinion.

Overview of the financial performance of the NHS in Scotland 2005/06

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www.audit-scotland.gov.uk ISBN 1 905634 43 9 AGS/2006/14

This publication is printed on uncoated paper, made from a minimum of 80% de-inked post-consumer waste.