

Government and Public Sector

July 2007

# NHS Shetland

## Annual Report to Members



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16 July 2007

Our ref: CDR/MW

Ladies and Gentlemen

**Annual Report to Board Members 2006/07**

We have completed our audit of NHS Shetland and its financial statements for the year ended 31 March 2007.

The Annual Report which follows is primarily designed to direct your attention to matters of significance that have arisen out of the 2006/07 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

We would like to take this opportunity to offer our thanks to those members of management and staff who have assisted us during the course of the audit.

Yours faithfully

PricewaterhouseCoopers LLP

# 1. Executive Summary



## Our Audit Opinion

- 1.01 Our audit opinion concerns both the true and fair statement of NHS Shetland (“the Board’s”) financial results for the year ended 31 March 2007 (2006/07) and the regularity of its income and expenditure in the year.
- 1.02 We are pleased to report that our opinion on the true and fair view on the financial statements is unqualified.
- 1.03 Our regularity opinion on income and expenditure is also unqualified.
- 1.04 We also provide a view as to whether those parts of the Remuneration Report 2006/07 subject to audit have been properly prepared. Our opinion on the Remuneration Report 2006/07 is unqualified. Our audit opinion does not extend to any other part of the Directors’ Report.

## Financial Targets and Performance

- 1.05 The Board’s performance against its three financial targets was as follows:

Financial Targets	Achievement
Net resource limit should not exceed the Revenue Resource Limit (“RRL”)	The Board spent £39.191 million against its RRL of £39.561 million, resulting in a surplus of £0.370 million.
Capital Resource Limit (“CRL”)	Total capital spend was £2.825 million against a CRL of £3.493 million.
Cash Requirement Target	The Board spent £39.665 million thus complying with the cash requirement target of £39.700 million.

- 1.06 The Board achieved a £0.370 surplus for the year compared to the predicted break-even position reported in the financial plan at the beginning of the year. It should be noted that the Board carried forward £0.341 of funding from 2005/06 and so in-year expenditure was £0.029 below the in-year allocation.
- 1.07 The Board is again projecting a break-even position in 2007/08 with a total savings target for the year of £0.852 million, all of which has now been identified .
- 1.08 Significant financial challenges remain for the Board, particularly around the continued Agenda for Change costs, potential reducing

(in real terms) core funding, continued roll-out of tariffs, implementation of a new financial ledger and continued negotiation with Shetland Islands Council over the full abatement of the revenue resource transfer.

### **Performance – Waiting Times**

- 1.09 The Board has allocated resources to meeting the current targets set by the SEHD. Targets are contained within the Local Delivery Plan, and regular reports on all aspects of Waiting Times achievements are made to the Board.
- 1.10 The Scottish Executive Health Department introduced a target that no patient should wait longer than 26 weeks for inpatient, day case or outpatient treatment by 31 December 2005, and 18 weeks from 1 January 2007 for inpatient/day case treatment. The Board met these targets both for treatment provided locally and for treatment provided elsewhere in Scotland (principally Aberdeen).
- 1.11 Further detail about financial results 2006/07, forecast financial results for 2007/08 and performance is given in **Sections 4 and 5** of this report.

### **Service Sustainability and Modernisation**

- 1.12 The Board is not planning any major redesign in terms of service delivery. However, within the Hospital Capital Plan, approved in principle at the October 2006 Board Meeting, all the clinical services currently provided at Montfield Hospital would be relocated (subject to public consultation) to the Gilbert Bain Hospital site.
- 1.13 A capital plan for the proposal has been prepared and approved by the Board supported by detailed costings, clinical modelling and staff consultation. A phased approach is to be adopted to minimise disruption and cost.

### **The Audit Process and Accounting Issues**

- 1.14 The financial statements and the majority of the supporting schedules were presented to us for audit within the timetable set by management. However, the limitations with the financial management system has meant the draft financial statements were not completed until June, creating a significant challenge to complete the audit process within the required timescales.
- 1.15 We have reported the need to update the financial management systems in our interim audit reports.
- 1.16 In this regard, NHS Shetland has held provisional discussions with NHS Ayrshire & Arran regarding potential Consortium working. NHS Ayrshire & Arran are looking to establish a potential Pathfinder model proposal, within a Consortium of Health Boards, to demonstrate a shared delivery of financial services across a cluster of Boards.

- 1.17 These discussions remain on-going and it is strongly recommended that management seek resolution of this issue within the 2007/08 financial year, including the earlier completion of the Annual Accounts for audit.
- 1.18 We are required to report any unadjusted errors to those charged with governance. As a result of our work to date, we proposed a number of audit adjustments and all but one have been processed by management within the final 2006/07 Annual Accounts.
- 1.19 This relates to a refund of VAT of £0.136 million received in the year regarding capital works, completed in prior years, on the Brae Health Centre. This refund has been offset against Fixed Asset – Land and Buildings – Additions, creating a negative value in year (Note 11a in the Financial Statements).
- 1.20 This refund should have been offset against Fixed Asset – Land and Buildings – Revaluations. There is no net effect on the value of assets by this unadjusted difference and management have outlined their decision not to process this adjustment within the Annual Letter of Representation. It does not materially impact upon the true and fair view of the financial statements.

#### **Systems of Internal Control**

- 1.21 The Code of Audit Practice requires us to review and report on the Statement of Internal Control given in the accounts. Based on our normal audit procedures, we do not disagree with the disclosures contained within the Statement of Internal Control.
- 1.22 Details of control matters noted during the course of our audit are set out in **Section 7**.

#### **Governance Arrangements**

- 1.23 A summary of the work we have performed in the year in relation to the Board's Governance arrangements is set out in **Section 8**. There were no significant areas for improvement arising from our work.

#### **Other Business Matters**

- 1.24 As part of our audit, we have obtained and documented certain information relating to the Board in a number of areas including business risks, the Quality and Outcomes Framework (QOF); and NHS Tariffs.
- 1.25 A summary of this work is set out in **Section 10**, along with a number of recommendations for further action.

## 2. Introduction



- 2.01 Our overall responsibility as external auditor of NHS Shetland is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in March 2007.
- 2.02 In this regard, the Code sets out the need for public sector audits to be planned and undertaken from a wider perspective than in the private sector involving not only assurance on the financial statements but also consideration of areas such as regularity, propriety, performance and the use of resources.
- 2.03 It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving not only the “appointed auditor”, but importantly the Auditor General for Scotland and other auditors such as Audit Scotland’s Health Performance and Public Reporting Group.
- 2.04 Our audit has been planned and conducted to take account of these wider perspectives.
- 2.05 NHS Shetland and the Chief Executive are, together with other matters, responsible for:
- Ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
  - Maintaining proper accounting records; and
  - Preparing financial statements which give a true and fair view of the financial position and expenditure and income, in accordance with the Financial Reporting Manual.
- 2.06 In this regard, we are responsible for issuing an audit report (opinion) on:
- Whether the financial statements give a true and fair view of the financial position and expenditure and income
  - Whether the financial statements have been properly prepared in accordance with relevant legislation, accounting standards and other reporting requirements
  - The regularity of expenditure and income

- 2.07 Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260: "*Communication of audit matters to those charged with governance*", we are required to communicate audit matters of governance interest arising from the audit of financial statements to those charged with governance of an entity.
- 2.08 This Annual Report to Members summarises key aspects of our work throughout the audit year, highlighting any matters which we believe should be brought to your attention. Therefore this Report, together with previous reports to the Audit Committee throughout the year discharging the requirements of ISA 260.

#### **Acknowledgements**

- 2.09 We would like to thank all NHS Shetland managers and staff involved for their assistance throughout the audit process.



# 3. Independent Auditors' Report and Key Financial Targets

## Our Audit Opinion

- 3.01 Our audit opinion concerns both the true and fair statement of NHS Shetland ("the Board's") financial results for the year ended 31 March 2007 (2006/07) and the regularity of its income and expenditure in the year.
- 3.02 We are pleased to report that our opinion on the true and fair view on the financial statements is unqualified.
- 3.03 Our regularity opinion on income and expenditure is also unqualified.
- 3.04 We also provide a view as to whether those parts of the Remuneration Report 2006/07 subject to audit have been properly prepared. Our opinion on the Remuneration Report 2006/07 is unqualified. Our audit opinion does not extend to any other part of the Directors Report.
- 3.05 Our opinion is set out in full in **Appendix 3**.

## Financial Targets

- 3.06 The Board's performance against its three financial targets were as follows:

Financial Targets	Achievement
Net resource limit should not exceed the Revenue Resource Limit ("RRL")	The Board spent £39.191 million against its RRL of £39.561 million, resulting in a surplus of £0.370 million.
Capital Resource Limit ("CRL")	Total capital spend was £2.825 million against a CRL of £3.493 million, an underspend of £0.668 million.
Cash Requirement Target	The Board spent £39.665 million thus complying with the cash requirement target of £39.700 million.

- 3.07 The Board achieved a £0.370 million surplus for the year compared to the predicted break-even position reported in the financial plan at the beginning of the year. It should be noted that the Board carried forward a £0.341 million surplus from 2005/06 and so in-year expenditure was £0.029 million below the in-year allocation.

# 4. Financial Performance 2006/07



- 4.01 NHS Shetland is responsible for conducting its affairs and for putting in place proper arrangements to ensure that its financial position is soundly based.

## Financial Performance in the Year

- 4.02 It is emphasised that we do not express a specific audit opinion on the figures on the following pages – these have been extracted in agreement with management from various reports, supporting papers and detailed discussions with management.
- 4.03 The table below identifies the difference between recurring expenditure and income, the difference between non recurring expenditure and income, and corporate savings achieved in 2006/07.

### NHS Shetland - Actual Financial Position 2006-07

NHS BOARD	£M	£M
Recurring Income	32.0	
Recurring Expenditure	(33.2)	
<b>Underlying recurring deficit</b>		<b>(1.2)</b>
Non-Recurring income	6.7	
Non-recurring expenditure	(6.5)	
Balance of non-recurring		0.2
<b>Gap</b>		<b>(1.0)</b>
Non-recurring SEHD income/year-end support	0.77	
Corporate savings programme	0.60	
<b>Total other income</b>		<b>1.37</b>
<b>Financial surplus for 2006-07</b>		<b>0.37</b>

- 4.04 The above table highlights the £0.370 million surplus. After taking account of the 2005/06 surplus carried forward to 2006/07, an in-year surplus of £0.029 million was achieved.
- 4.05 The Board was successful in containing costs within revenue limits, particularly in the face of increased costs associated with prescribing and hospital drugs and the continued implementation of Agenda for Change and NHS tariffs.

4.06 This was achieved by a series of measures, the main elements of which were: -

- An agreement with Shetland Islands Council to waive the Revenue Resource Transfer, payable by the Board, in the region of £1.15 million for 2006/07; and
- Achievement of the cost containment programme of £1.2 million, through top-sliced budget reductions of £0.635 million and efficiency savings of £0.627 million (£0.60 million from the corporate savings programme).

#### Actual Out-turn Against the Plan

4.07 The following table and paragraphs explain the in-year financial performance and why the predicted break-even position became a £0.370 million surplus by the year-end.

<u>NHS Shetland</u>	<u>£'m</u>	<u>£'m</u>
<b><u>Projected versus Actual Financial Position</u></b>		
<b><u>2006/07</u></b>		
<b>Initial projected financial position for 2006/07</b>		<b>0</b>
<b>1. Additional Cost Pressures:</b>		
Additional spend on locums and agency staff (refer to paragraph 4.08)		(0.850)
<b>2. In-year Cost Savings:</b>		
Reduction in recruitment and relocation expenses (refer to paragraph 4.09)	0.202	
Renegotiation of tariff rates for patients treated outside of Shetland (refer to paragraph 4.11)	0.146	
Utilisation of 2005/06 surplus and reserves (refer to paragraph 4.12)	0.610	
Other	0.186	
	<hr/>	1.144
<b>3. Miscellaneous Income</b>		<b>0.076</b>
<b>Actual financial position for 2006/07 (per Annual Accounts) - surplus</b>		<b><u>0.370</u></b>

#### ***Locums and agency staff - (£0.850 million overspend)***

4.08 NHS Shetland carried some significant clinical vacancies during the year 2006/07. Despite an amount in the initial financial plan to cover locum costs, vacancies in key areas required additional spend, in particular as follows: -

- Surgical locum - £0.305 million overspend
- Psychiatric locum - £0.169 million overspend
- Obstetrics locum - £0.343 million overspend

#### ***Relocation and recruitment expenses - (£0.202 million underspend)***

4.09 In terms of relocation expenses, the underspend occurred due to the unpredictability of the timing of eligible employees' claims - the entitlement to removal expenses spans two calendar years and therefore does not occur evenly.

4.10 The underspends in the recruitment budget reflect some of the measures put in place by the Board to reduce expenditure in this area, including:

- Use of national contracts for advertising
- Use of composite adverts
- Use of composite recruitment processes where possible (e.g. where there are two similar posts vacant)

#### ***Renegotiation of tariffs (£0.146 million underspend)***

4.11 The improvement is primarily due to a successful negotiation with Grampian NHS Board relating to the introduction of national tariffs in 2006/07. The two Boards have agreed to limit the financial impact on NHS Shetland in order to avoid any undue destabilising of the financial position across the region. This agreement has reduced the cost impact of the tariffs on NHS Shetland.

#### ***Utilisation of 2005/06 surplus and reserves (£0.610 million underspend)***

4.12 This primarily relates to the carried forward £0.341 million of funding from 2005/06 and release of reserves in-year. This release includes an unused provision of £0.068 million for premature retirements.

### Savings Plans and Efficient Government Targets

- 4.13 A £1.2 million shortfall was highlighted in the initial 2006/07 financial plan. An outline savings plan to achieve this was presented to the Board in April 2006. This consisted of proposed budget reductions of £0.635 million, and efficiency savings of £0.627 million.
- 4.14 A further report on the efficiency savings plan was presented to the Board in May 2006. This linked the savings required to balance the budget with the Scottish Executive's "Efficient Government" targets. This listed individual schemes with risk rankings totalling £0.6 million. Of this figure, £0.374 million was identified as counting towards the 2006/07 Efficient Government target of £0.328 million.
- 4.15 NHS Shetland was successful in achieving these targets and reported this matter to the Board in May 2007.

### In-year Capital Spend

- 4.16 The 2006/07 Capital Resource Limit was set at £3.493 million and the reported out-turn within the 2006/07 Annual Accounts is £2.825 million. This represented an underspend of £0.668 million.
- 4.17 Spending on key areas can be summarised as follows: -

Description	2006/07 Spend £ms
Refurbishment of Breiwick House	0.689
Major Medical Equipment	0.730
Car Park – Gilbert Bain Hospital	0.117
Capital Grants	0.948
Various other additions	0.341
<b>TOTAL</b>	<b>£2.825</b>

# 5. Forecast Financial Position for 2007/08



5.01 For the purposes of this report, the projected position of the Board for 2007/08 has been summarised in the table below.

<b>NHS Shetland - Projected Financial Position 2007-08</b>	<b>£m</b>	<b>£m</b>
Recurring Income	36.5	
Recurring Expenditure	(37.7)	
<b>Underlying recurring deficit</b>		<b>(1.2)</b>
Non-Recurring income	3.9	
Non-recurring expenditure	(3.6)	
Balance of non-recurring		0.3
<b>Gap</b>		<b>(0.9)</b>
Non-recurring SEHD income/year-end support	0.7	
Corporate savings programme	0.2	
<b>Total other income</b>		<b>0.9</b>
<b>Projected Out-turn for 2006-07</b>		<b>0</b>

## **Recurring Income 2007/08**

- 5.02 The projected out-turn position includes a 6% increase in its general allocation and the carry-forward of the £0.370 million surplus from 2006/07.
- 5.03 In addition to the general allocation funding from the SEHD, approximately 20% of the Board's revenue is generated from other sources e.g. Primary Medical Services. No confirmation has been received from the SEHD regarding this funding and the Board has not anticipated any uplifts in the 2007/08 financial plan.

## Cost Pressures and Risks

- 5.04 To achieve the projected break-even position, a number of additional challenges and pressures exist. These have been identified within the Board's 2007/08 financial plan and can be summarised as follows :
- Allocation for Primary Medical Services – as outlined above, the funding has yet to be confirmed by the SEHD, but any reduction in funding in this area could create a significant pressure.
  - Revenue Resource Transfer - No budget has been provided for the amounts potentially due to Shetland Islands Council (estimated to be approximately £1.1 million) – the Board are assuming that the successful negotiation of abatement in previous years will continue.
  - Pay Awards and Agenda for Change – the Board has assumed a 2.5% (£0.44 million) inflationary increase in pay awards and 1.5% (£0.264 million) on progression of incremental points. However, the review process and back-fill requirements of additional annual leave remain a financial pressure.
  - National Tariffs – the implementation of tariffs creates a financial challenge for NHS Shetland. The effect, and subsequent management action has been outlined in the paragraphs below.
  - The continued achievement of savings targets.

## Tariffs

- 5.05 It is the policy of the Scottish Executive Health Department (SEHD) to implement the national tariff over two years. The financial year 2007/08 is the second year of this policy and it is therefore expected that tariffs will be implemented in full.
- 5.06 The approximate increase in the cost of the service level agreement with Grampian NHS Board as a result of this policy is estimated by NHS Shetland management to be £0.62 million at 2007/08 inflation rates. However, the SEHD is aware of the significance of the financial impact of the tariff policy on NHS Shetland and has indicated a willingness to allow the Board to negotiate directly with NHS Grampian with a view to mitigating the impact.
- 5.07 Negotiations have already been held and as a result, NHS Grampian has agreed in principle to limit the impact of tariffs to £0.271 million.
- 5.08 This would allow a reduction in costs of £0.39 million which can be used to contribute to the savings required to break-even.

## ACTION POINT 1

## Capital

- 5.09 The Board's initial capital allocation for 2007/08 has been set at £5.283 million. The main elements of spend are: -
- An allocation of £1.2 million for the Redevelopment of Outpatient Services.
  - An allocation of £1 million for Phase 1 of the Hospital Capital Plan.
  - An allocation of £0.35 million to extend the Whalsay Health Centre to include a dental suite.
  - An allocation of £1.2 million for a Joint Therapies Unit project in conjunction with Shetland Islands Council.

## Summary of Financial Position and Projections

- 5.10 It is evident from the analysis above that the Board has been successful in achieving its targets for 2006/07 against a backdrop of financial pressures such as pay modernisation initiatives, rising drug costs and the introduction of tariffs.
- 5.11 However, it should also be highlighted that an underlying deficit in the region of £1.2 million exists within the Board and this continues to be managed to an extent through non-recurring actions.
- 5.12 Significant financial challenges remain for the Board, particularly around continued Agenda for Change costs, reducing (in real terms) core funding, the continued introduction of tariffs and the Hospital Capital Programme.
- 5.13 With this in mind, the Board remains committed to restoring underlying financial balance and is seeking to develop strategic solutions during the course of 2007/08. The Board has a Five-Year Financial Strategy that has been agreed by the Scottish Executive Health Department, which would see a return to underlying financial balance in 2011/12.
- 5.14 In the interim years there is an assumption that the arrangements with Shetland Islands Council concerning Revenue Resource Transfer will be repeated, but this is not agreed formally for future years and therefore represents one of the key risks to the Board's financial strategy.

## ACTION POINTS 2 AND 3



# 6. The Audit Process and Accounting Issues



## **Audit Process**

- 6.01 The financial statements and supporting schedules were presented to us for audit within the timetable set by management. The quality of working papers provided and internal review process undertaken by management were of a good standard.
- 6.02 However, we have raised an issue regarding the timeliness of the preparation of the draft financial statements to enable adequate time to be available for audit completion and reporting. We have also raised a recommendation that management implement a new financial management system as a matter of urgency (refer to paragraph 6.11)

## **Preparation of Financial Statements**

- 6.03 The Financial Statements were prepared in accordance with the accounting requirements contained in the NHS Accounts Manual available for Annual Report and Accounts of Unified NHS Boards, and supplementary guidance, as issued by the Scottish Executive Health Department (SEHD) and approved by the Scottish Ministers.
- 6.04 These financial statements have been prepared under the accounting policies set out within them.

## **Financial Statements Approval**

- 6.05 The Financial Statements were submitted to the Board's Audit Committee on the 28th June 2007 and approved and adopted at the Board meeting on the same day.

## **Accounting Issues**

- 6.06 We noted several accounting issues during the course of our audit of the financial statements and the following are brought to your attention.

### *Financial Ledger*

- 6.07 As previously reported to the Audit Committee in our follow-up of 2005/06 Audit Recommendations, limitations with the financial management system has meant that the draft financial statements were not completed until June, creating a significant challenge to complete the audit and reporting process within the required timescales.

- 6.08 Board management have previously been reluctant to invest in a more efficient system due to the impending National Shared Services Project. However, the Board has now responded to the uncertainty surrounding this project, particularly the scope and timescales.
- 6.09 The Board has held provisional discussions with NHS Ayrshire & Arran regarding potential Consortium working. NHS Ayrshire & Arran is looking to establish a potential Pathfinder model proposal, within a Consortium of Health Boards, to demonstrate a shared delivery of financial services across a cluster of Boards.
- 6.10 These discussions remain on-going and it is strongly recommended that management seek resolution of this issue within the 2007/08 financial year.
- 6.11 The eventual successful implementation of a new financial management system depends on the level of funding and support provided by the host body and the SEHD. In addition, the recent retiral of NHS Shetland's Finance Manager has created a resourcing and knowledge retention issue within the finance function.

#### **ACTION POINT 4**

##### ***Fixed Assets***

- 6.12 Due to the limitations on the functionality of the General Ledger, Fixed Asset data is held in a suite of spreadsheets. These spreadsheets hold relevant financial data for Fixed Assets and are used to perform calculations on, for example, depreciation, revaluations, impairments at the year end.
- 6.13 However, the requirement for manual input creates a risk of error and misstatement and as such requires a high level of audit work in order to obtain audit comfort. Indeed, our audit work did reveal a number of adjustments to the fixed asset values, none of which were material and all but one of which were adjusted by management and reflected in the final Financial Statements (see paragraphs 1.19 to 1.20).
- 6.14 Management are planning to incorporate a fixed asset module within the new financial ledger package.

#### **ACTION POINT 5**

##### ***Discount rate for provisions***

- 6.15 The pension and injury benefits provisions included within the financial statements are discounted because the period in which the outflow of cash is expected to occur is some years in the future. The value of money will change in that period of time and applying a discount rate accounts for that change. The discount rate prescribed by HM Treasury for 2006/07 was 2.2%, compared to 2.8% in 2005/06.
- 6.16 However, guidance issued during the year by the Scottish Executive Health Department (SEHD) has led to some

inconsistency in the application of the new discount rate across Scottish Health Boards. As a result, NHS Shetland sought written clarification from the SEHD regarding the correct rate and, in common with certain other Health Boards, were informed to use the previous discount rate of 2.8%.

- 6.17 NHS Shetland initially followed this advice and used the discount rate of 2.8% to calculate the provision within its 2006/07 Annual Accounts, even although 2.2% is the more accurate rate. However, following discussion with audit, NHS Shetland used the 2.2% discount rate and amended its provision calculation accordingly.

#### **Remuneration Report - Disclosure**

- 6.18 The Remuneration Report contained within the Financial Statements contains details of the Board members and senior employees remuneration.
- 6.19 However, as they are entitled under the Data Protection Act 1998, certain Executive members have withheld their consent to disclose certain information, and this has been identified as such in the financial statements.

#### **Audit Adjustments**

- 6.20 Following the introduction of ISA 260 we are required to report all unadjusted differences to management and to invite management to adjust them. In the event that management believe the amounts are insufficiently material to adjust, we require specific representation to this effect and report any non-adjustments to those charged with governance (Audit Committee and the Board).
- 6.21 As a result of our work to date, we proposed a number of audit adjustments and all but one of these have been processed by management and reflected in the final 2006/07 Annual Accounts.
- 6.22 Details of this unadjusted amount are outlined at paragraphs 1.18 to 1.20.

#### **PFI/PPP contracts**

- 6.23 The Board does not have any PFI/PPP arrangements in place at present, and does not at this stage anticipate their use in future periods.

#### **Agenda for Change**

- 6.24 In common with other NHS bodies in Scotland, the Board is currently facing a number of reviews with regards to gradings following the assimilation process. An amount of £0.432 million has been provided within the 2006/07 accounts to cover the outcome of these appeals.

#### **Equal pay claims**

- 6.25 Article 141 of the Treaty of Rome requires member states to ensure and maintain "the application of the principle that men and

women should receive equal pay for equal work". This was expanded on in the Equal Pay Directive which made it clear that all such discrimination should be eliminated from all aspects of remuneration.

- 6.26 The National Health Sector in Scotland has received a number of claims for backdated pay increases, arising from this required pay parity between these different categories of employees.
- 6.27 As at 31 March 2007 NHS Shetland had not received any claims. However, in order to recognise the issue, a statement has been included within Note 21 – Contingent Liabilities, within the 2006/07 Annual Accounts.

#### **ACTION POINT 6**

# 7. Systems of Internal Control



**Statement on Internal Control**

- 7.01 The Code of Audit Practice requires us to review and report on the Statement of Internal Control given under the relevant code before its publication.
- 7.02 The Board has used the correct format for its statement as prescribed in the Manual of Accounts and has outlined the processes designed to identify and evaluate risks. In addition, key elements of the Board’s control framework have been highlighted including work on risk management, internal audit, the various governance committees, and the performance and financial reporting to the Board.
- 7.03 The Statement also outlines areas where the Board plans to improve internal control. These include the embedding of the new Controls Assurance Group and the revised Clinical Governance and Risk Management Strategies and training for relevant staff on new risk management standards.
- 7.04 Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

**Follow Up Report on previous control matters**

- 7.05 We followed up the Board’s progress in implementing recommendations made by the previous external auditors and our Follow Up report was presented to the Audit Committee.
- 7.06 Of the 21 agreed recommendations made in the reports issued in 2005/06 progress at the time of reporting was as follows:

Status	Annual Report to Members 2005/06	Interim & Final Management Reports 2005/06	Total
Action Implemented	0	4	4
Action in Progress	3	3	6
Limited/Little Progress to Date	1	2	3
Implementation Date Not Yet Due	0	8	8
<b>Total</b>	<b>4</b>	<b>17</b>	<b>21</b>

7.07 The three recommendations where we have reported “little action to date” can be highlighted as follows :

- The Board should ensure that robust arrangements are in place to demonstrate that Efficient Government savings targets have been met (Section 2 – Annual Report to Members)
- As part of work to align departmental risks to Corporate Risks (planned for March 2007) management should ensure that a full risk assessment is undertaken for all areas. (Section 3 – Annual Management Letter)
- Stock reconciliations are a key financial control and should be performed and authorised as a matter of priority, with any differences appropriately investigated (Section 4 – Interim Management Letter).

7.08 Whilst we did not class any of these as business critical, we recommended that management seek to action these as a matter of priority. Progress will be assessed as part of the 2007/08 audit process.

#### **Financial Systems and our 2006/07 Internal Controls Report**

7.09 Our Internal Controls Report was presented to the Audit Committee in May 2007. The report contained a number of recommendations to improve controls, four of which were graded as high risk:

- It is important that the Board establishes a systematic, prioritised approach to the investigations and puts in place a mechanism for monitoring and reporting progress with the National Fraud Initiative.
- Given that the capability of the ledger necessitates the use of spreadsheets to store Fixed Asset data, management should ensure that these are at least password protected and access restricted only to senior Finance staff.
- The Senior Management Team should ensure that the Information Support Group recommences a programme of regular meetings which seek to address the Board’s medium to long term IT requirements.
- The Information Support Group should instigate a Disaster Recover Plan (DRP) project. This will involve consulting with end users to establish the relative criticality of the business systems in use throughout NHS Shetland and then prioritising the development of DRPs where required.

7.10 The Board has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. We will follow up the action plan during our 2007/08 audit.

#### **ACTION POINT 7**

### **Control Weaknesses Identified**

- 7.11 A number of other control weaknesses were identified during the course of the final audit. The majority were of a minor nature and will be reported in a Final Management letter to the Director of Finance.

### **ACTION POINT 8**

### **Internal Audit's Report on the Board's Internal Controls**

- 7.12 The extract of the Internal Auditor's opinion for 2006/07 is reproduced below:

*"On the basis of the internal audit work carried out during the year ended 31 March 2007, we conclude that NHS Shetland's established internal control procedures were adequate to meet the control objectives agreed with management for each system reviewed"*

# 8. Governance Arrangements



8.01 Through good governance, NHS boards are able to improve services for patients and the working lives of staff that care for them. Governance means setting the strategic direction within the parameters laid down by the Scottish Executive Health Department’s policies, providing leadership, setting the tone for the whole organisation, overseeing the control of the Board’s work and reporting activities and progress to stakeholders. NHS board members are, therefore, collectively responsible for the success of their organisation.

8.02 Governance within the NHS can be considered under four main headings:

Financial and Performance Governance	The proper management of resources and a sound financial standing will enable the organisation to achieve its aims and objectives to meet its obligations as and when they fall due.
Clinical Governance	The Board should have an established clinical governance framework which supports and monitors standards for care, creates an environment for the continuous improvement of services, supports strategic planning and facilitates service delivery.
Risk Management	Responsibility is placed on the Board and primarily the Accountable Officer in the Statement of Internal Control to maintain a sound system of internal control and comply with all applicable laws and regulations.
Staff Governance	NHS employers are expected to have systems in place to identify areas that require improvement and to develop action plans that describe how improvements will be made. The underlying principal is that NHS Boards should recognise that investing in staff will allow them to deliver services to the best of their ability in modern healthcare settings.

8.03 NHS Shetland’s Board and Committee structures have been developed over time. The Board discharges its governance role through the following committees:

- Audit;
- Clinical Governance ;
- Staff;



- Ethics; and
- Discipline.

### **Financial and Performance Governance**

- 8.04 The NHS Board meets on a six-weekly basis to progress the business of the Health Board. Finance and performance are standing agenda items. Each meeting considers the monthly financial performance and projections and the key areas of performance, for example, waiting times.
- 8.05 The Board has established a Service Redesign Committee to drive and monitor the service modernisation agenda, to be delivered primarily through the Hospital Capital Plan. Regular reports, together with an Annual Report, are prepared for the Board.
- 8.06 The Board has also established an Audit Committee to provide the Board with assurance that adequate control systems are in place to allow the organisation to manage risks. The Committee meets quarterly to consider all aspects of control, particularly financial. The Committee receives and discusses reports from internal and external audit and scrutinises the final accounts on behalf of the Board.

### **Clinical Governance**

- 8.07 The Clinical Governance Committee of the Health Board has two key roles:
- Systems assurance – to ensure that clinical governance mechanisms are in place and effective throughout the local NHS System; and
  - Public health governance – to ensure that the principles and standards of clinical governance are applied to the health improvement activities of the NHS Board.
- 8.08 The membership of the Clinical Governance Committee comprises four non-executive Board members with executive directors and key managers in attendance. The Committee has a general duty of maintaining oversight of the arrangements for clinical governance and risk management within the Board's area in accordance with the policies of the Board, statutory requirements, guidance issued by the Scottish Executive and guidance issued by Quality Improvement Scotland.
- 8.09 Whilst the Committee has overall interest in risk management, its particular emphasis is on clinical risk. The Board has recently reviewed its Clinical Governance and Risk Management Strategies. As a result of this, a Controls Assurance Group has been established (chaired by the Chief Executive) which has overall responsibility for risk management and for reporting any risk issues to the Board.

- 8.10 An updated Clinical Governance Strategy was drafted and approved by the Board in March 2007.
- 8.11 This strategy sets out the current model of clinical governance delivery in Shetland and describes the corporate objectives, which underpin the further development of the clinical governance infrastructure. Strategic objectives and actions plans are detailed within the strategy.
- 8.12 The Board completed the self-assessment submission to NHS Quality Improvement Scotland (QIS) on the standards for clinical governance and risk management. QIS conducted a visit in May 2007 to assess the scoring and rationale of the submission.
- 8.13 The Board is currently awaiting the final QIS report.

## **ACTION POINT 9**

### **Risk Management**

- 8.14 Risk management is often defined as a systematic process for identifying, assessing, controlling, monitoring, reviewing and auditing risk. Effective risk management is of critical importance to the health service as adverse consequences of risk could place limitations on the quality of health care delivery, and put a strain on staff and financial resources.
- 8.15 Health Boards are required to implement a robust and effective framework for the management and understanding of risk. The framework should be developed by building on existing good practice and should be used to facilitate planning and decision making processes.
- 8.16 As outlined above, the Audit Committee and Clinical Governance Committee consider risks in their particular areas. However, within NHS Shetland, the Board retains responsibility for the management of risk in its entirety. The Board delegates the development and detailed work associated with its implementation to the Controls Assurance Group and the Clinical Governance Coordinating Group (CGCG), which reports to the Clinical Governance Committee (CGC).
- 8.17 In addition to recently approving the Risk Management Strategy 2007-2010, other key processes established by the Board include :
- Regular reports from managers on the steps they are taking to manage risks in their areas of responsibility including progress reports on key projects and the corporate action plan;
  - Implementation of a prioritisation methodology based on risk ranking as defined in the Australian/New Zealand Risk Management Standards 4360:2004 (the international standard required by NHS Quality Improvement Scotland);
  - Regular performance monitoring reports to the board (which were enhanced during 2006/07 to better reflect the NHS HEAT targets);

- An overarching Corporate Action Plan setting out the Board's key aims and objectives for the year, with updates reported to the Board quarterly;
  - Maintenance of an organisation-wide risk register.
- 8.18 In 2006/07 further staff training was provided in order to embed the Australian/New Zealand Risk Management Standards 4360:2004. A new programme of risk training is being prepared following a training needs assessment questionnaire, circulated within the organisation.
- 8.19 These measures are taking place in tandem with a management review that took place in 2006/07. One of the key aims of this review was to strengthen and formalise the Board's arrangements for performance management by separating this from operational management wherever possible. The Board also revised its performance monitoring reports in order to reflect the key HEAT targets defined by the Scottish Executive Health Department.

### **Staff Governance**

- 8.20 The NHS Reform (Scotland) Act amended the National Health Service (Scotland) Act 1978, making it a legal requirement for Health Boards to have in place arrangements for good governance of staff. It is the duty of every Health Body to put and keep in place arrangements for the purposes of:
- Improving the management of the officers employed by it;
  - Monitoring such management; and
  - Workforce planning.
- 8.21 Within NHS Shetland, the Staff Governance Committee oversees the consistency of policy and equity of treatment of staff across the local NHS system, including remuneration issues.
- 8.22 The membership of the staff governance committee comprises the Chairman and Vice-Chairman of the Board, Employee Director, Chairman of the Board's Audit Committee and three members nominated by partnership – two staff side and one management side. The Chief Executive and the Director of Human Resources are in attendance.
- 8.23 The Committee ensures that the Board adheres to its statutory requirements under Staff Governance. The Staff Governance Committee review the Board's action plans, progress and self-assessment in line with regulatory requirements.
- 8.24 The Board's Remuneration Committee is a sub-committee of its Staff Governance Committee.
- 8.25 NHS Shetland also has a Workforce Planning Group, which is chaired by the Director of Human Resources and has a membership of key operational managers and staff representatives.

# 9. Prevention and Detection of Fraud and Irregularities



## **Responsibility with respect to Fraudulent and/or Illegal acts**

- 9.01 The preparation of the financial statements is the responsibility of management. Our responsibility as auditor is to express an opinion on those financial statements.
- 9.02 Effective internal control reduces the likelihood that errors, fraud or illegal acts will occur and remain undetected. However, it does not eliminate that possibility. Our responsibility regarding fraud is to obtain reasonable assurance that material misstatements resulting from fraud will be detected.
- 9.03 Accordingly, while we cannot guarantee that all errors, fraud or illegal acts, if present, will be detected, we will design our audit to provide reasonable, but not absolute, assurance of detecting errors or fraud that would have a material effect on the financial statements as well as illegal acts having a direct and material effect on the financial statements.

## **Fraud and Corruption Reviews**

- 9.04 As part of our rotational plan to review the key mechanisms for the prevention and detection of fraud and corruption, we have reviewed the Board's fraud and corruption internal policy and regulations for members and staff conduct. No significant weaknesses were identified through these reviews.
- 9.05 As part of our audit, we examine journal entries and accounting estimates for bias and add an element of unpredictability in audit procedures year to year.
- 9.06 Our enquiries of management and our testing of financial records for the purposes of our normal audit responsibility did not reveal any illegal or possible illegal acts. However, improper conduct is usually carefully concealed and consequently, the probability is not high that our regular audit work, however diligently performed, will bring it to light.

## **National Fraud Initiative**

- 9.07 In 2006/07 the Board took part in the National Fraud Initiative (NFI) in Scotland. The Health Department and NHS Counter Fraud Services has strongly supported the involvement of health bodies in the exercise, which is undertaken as part of the audits of the participating bodies.
- 9.08 NFI brings together data from health bodies, councils, police and

fire and rescue Boards, and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. Health bodies provided payroll data for the exercise.

- 9.09 The NFI 2006/07 results (data matches) were made available to health bodies on 29 January 2007 via a new secure web-based application. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application. We monitored the Board's involvement in NFI 2006/07 during the course of the audit.
- 9.10 The Board ensured accountability for the process by delegating the detailed work of clearing matches to the Payroll Manager.
- 9.11 The Payroll Manager, who works closely with HR, prepares and provides regular updates to the Director of Finance, who subsequently updates the information on the web-based monitoring system.

#### **ACTION POINT 10**

##### **Fraud Guidance**

- 9.12 We have reviewed the fraud and irregularities guidance issued by Audit Scotland during 2006/07 and certain HDLs issued by SEHD, and undertaken work accordingly. There were no matters arising from this work.

##### **Fraud Submission**

- 9.13 Our interim audit work revealed that an alleged fraud had taken place in relation to Patients Travel and had been reported to the November 2006 Audit Committee. Whilst the sum involved was immaterial in terms of financial statements impact (approximately £100), we are required under the Code of Audit Practice to report this fraud to Audit Scotland. This was made through our Internal Controls and Governance Report 2006-07, and through the standard annual return made to Audit Scotland of any reported frauds that have occurred within the Board during the year.
- 9.14 It is also our understanding that the Audit Committee has requested that Internal Audit perform a review of the Patients' Travel system and report back to the Committee and we recommended within our interim audit report that all recommendations should be accompanied by a detailed action plan with deadlines and clear accountabilities.

#### **ACTION POINT 11**

# 10. Other Business Matters



## Priorities and Risks Framework

10.01 Audit Scotland publishes an annual Priorities and Risks Framework (PRF), a planning tool for auditors that sets out key high level risks facing Health Boards in Scotland. For 2006/07, the identified risk areas were categorised into the following areas:

- Service sustainability
- Financial management
- Governance
- Performance management
- People management
- Partnership working
- Information management

10.02 During the course of our audit, we considered each of the key risk areas highlighted within the PRF, the impact these areas have on the Board and planned our audit work accordingly. Financial management and governance have been detailed previously in separate sections (see sections 3 and 7). The significant points noted from the remaining sections have been detailed below.

## *Service Sustainability*

10.03 The Board approved its Local Delivery Plan (LDP) in March 2006 which links with a number of other plans such as Service Redesign, Pay Modernisation and Workforce Planning, as well as joint partnership arrangements with Shetland Islands Council via the Extended Local Partnership Agreement.

10.04 The Local Delivery Plan was developed in order to successfully link service delivery, financial constraints and the requirement to meet national targets. Progress against this is regularly reviewed by the Board.

10.05 In terms of service modernisation, the Board are not planning any major redesign in terms of service delivery. However, in October 2006 the Board announced the Hospital Capital Programme, a seven year plan to relocate services onto one hospital site rather than two (subject to public consultation). This would involve relocating Montfield-based clinical services onto the Gilbert Bain site.

10.06 A capital plan for the proposal has been prepared and approved by

the Board supported by detailed costings, clinical modelling and staff consultation. A phased approach is to be adopted to minimise disruption and cost.

- 10.07 The first phase of this programme has involved the re-provision of the Rehabilitation Service within the Gilbert Bain Hospital into other hospital wards. The second stage, which is on-going at the time of this report, is to relocate day surgery from the Gilbert Bain Hospital until a purpose-designed area is developed.
- 10.08 As outlined above, the Service Redesign Committee was formed to oversee the process of re-design and regularly reports to the Board on its progress.

#### **ACTION POINT 12**

#### ***Performance Management***

- 10.09 Key Performance Indicators (KPIs) are reported to the Board as a standing agenda item at each of its meetings. The majority of the performance report focuses on the targets within the Local Delivery Plan (LDP), with a particular focus on waiting times.
- 10.10 The Scottish Executive Health Department introduced a target that no patient should wait longer than 26 weeks for inpatient, day case or outpatient treatment by 31 December 2005, and 18 weeks from 1 January 2007 for inpatient/day case treatment. The Board met these targets both for treatment provided locally and for treatment provided elsewhere in Scotland (principally Aberdeen). These targets exclude patients to whom an Availability Status Code (ASC) has been applied. In Shetland, these codes relate to patients who are medically unfit for treatment, who elect to decline treatment or who fail to attend for treatment.
- 10.11 As at 31 March 2007 there were no patients without ASCs waiting more than 18 weeks for an inpatient/day case appointment within Shetland and 26 weeks for an outpatient appointment.
- 10.12 During 2006/07, the Board met the 62-day waiting time target in relation to cancer care, except for one patient.
- 10.13 A cancer monitoring team meets weekly under the lead of the Director of Clinical Services. At this meeting, every urgent cancer referral is reviewed and any problem areas are identified and dealt with as soon as possible. In addition, a number of clinical and procedural changes to pathways have and are being made to improve performance.
- 10.14 The Board has drawn up plans to deal with the abolition of ASCs, which will happen in December 2007 and has implemented the New Ways of Waiting in NHS Scotland ahead of the implementation date of 31 December 2007.
- 10.15 The national target for the maximum waiting time for outpatient treatment will reduce to 18 weeks by 31 December 2007. The Board are aware of these targets and are taking action to meet them.

## *People Management*

- 10.16 Agenda for Change is a major change programme in the NHS, designed to modernise pay structures, assist service delivery of patient care, aid recruitment and retention and allow for personal development of staff. The new pay structure consists of nine pay bands and several pay points within each pay band. Individual posts have been mapped to a pay band by either matching the job to the national profile or through a local job evaluation.
- 10.17 The original national timetable for two key elements of Agenda for Change was for all staff to be transferred to a new pay grade (“assimilated”) and have a validated Knowledge and Skills outline as part of the Knowledge and Skills Framework by October 2006. In common with many other Health Boards in Scotland, NHS Shetland has not met this timetable.
- 10.18 At the end of March 2007 99% of all phase 1 post-holders had been sent to NHS Grampian for assimilation. and the Board is currently continuing to implement the Knowledge and Skills Framework and the supporting system e-KSF. At present, 87% of staff are involved in KSF, but a KSF sub-group continues to work on this to reach 100%.
- 10.19 In 2006, NHS Shetland produced its first workforce plan outlining workforce requirements for the period to 2016. An updated plan was approved in April 2007
- 10.20 This revised plan takes account of a number of recent developments, including the Hospital Capital Programme, ongoing work in relation to Agenda for Change and the Knowledge and Skills Framework and the 4% HEAT target on sickness absence.
- 10.21 The Board has been working on delivering the Health, Efficiency, Access, Treatment (HEAT) target on sickness absence of 4% by March 2008. At 31 March 2007, the actual figure stood at 4.49%. Delivering this target is a key management objective and all managers within the Board have been set targets in this area.
- 10.22 The Human Resources Directorate is supporting managers to deliver this target, which has organisational, department and individual benefits. As part of this, the Promoting Attendance Policy has been revised and reissued.

## **ACTION POINT 13**



### *Partnership Working*

- 10.23 Community Health Partnerships (CHPs) were set up to facilitate the modernisation of the NHS and joint services. CHPs are intended to improve services by ensuring NHS staff work with local authority counterparts to plan and deliver local services. It is expected that CHPs will play an increasingly central role in the integration of local services as part of an ongoing programme of development and modernisation in public services.
- 10.24 The Board's geographic boundaries coincide with those of Shetland Islands Council and there is a long history of the two organisations working closely together. Most recently this has been through initiatives such as the Joint Futures agenda.
- 10.25 The Board has one CHP which is operated in conjunction with Shetland Islands Council and a range of community groups. This operates as a division of the Board and is integrated into its budgeting structure. It is responsible for the implementation of Joint Working across Shetland.
- 10.26 The Board and the local authority, Shetland Islands Council (SIC) set out their Joint Future plans and management arrangements in the Extended Local Partnership Agreement (ELPA). Within the ELPA there are joint future plans for a series of care groups. These plans outline key aims and objectives for the care group, information on needs and needs assessment, any gaps in service provision and planned actions.
- 10.27 Partnership working is driven by the Joint Future Joint Management Team which comprises representatives from all partners. Governance is overseen by the CHP Committee, which meets quarterly.
- 10.28 A CHP Development Plan 2006/07 is in place and progress against the targets has been reported to the CHP Committee throughout the year.

### *Information Management*

- 10.29 IM&T at the Board is delivered by the Computer Services Department (CSD). Strategic guidance for the department is provided by the Information Support Group.
- 10.30 It is governed by an IT Strategy which was finalised in January 2004. The Board has acknowledged the need for this strategy to be refreshed and to this end has approved a set of key themes for a revised policy. However, these have not yet been incorporated into the existing document to produce an updated strategy.
- 10.31 NHS Shetland has a Head of IM&T who also acts as the organisation's IT Security Officer. There is an Information Support Group which plays a key role in the governance of IM&T at NHS Shetland. This Group had not met for over a year, but is now meeting again on a regular basis.

- 10.32 Although a full Local e-Health Strategy is not in place, an eHealth Action Plan was approved by the January 2006 meeting of the Board – this effectively addresses the requirements of the HDL on eHealth.

#### **Quality and Outcomes Framework (QOF)**

- 10.33 One of the main changes within the General Medical Services (GMS) contract introduced in 2004 was to introduce a mechanism for measuring and paying for delivery of high quality services to patients within General Practice.
- 10.34 The mechanism to carry this out was entitled the “Quality and Outcomes Framework (QOF)”. The QOF measures achievement against various indicators as well as measures of care.
- 10.35 Practices achieve quality points for attaining the standards defined by the indicators, up to a maximum of 1,000 points.
- 10.36 All practices in Shetland received a Quality and Outcomes Framework (QOF) annual review visit in 2006/07. Overall QOF achievement levels were good with the overall average of 912 (91%), showing a slight down-turn on the previous year’s 993 (94.6%). This slight down-turn in performance is attributed to the fact that the clinical and organisational indicators have been revised and are more difficult to attain than in previous years.

#### **NHS Tariffs**

- 10.37 National tariffs are currently being phased into NHS Scotland, replacing the Service Level Agreements (“SLAs”) between Boards. These agreements are negotiated, agreed and signed documents that govern the key elements including charges of flows between Boards. A key purpose behind the tariffs is to create an incentive to increase efficiency by encouraging benchmarking between Boards by setting a single tariff rate across Scotland.
- 10.38 In 2005/06, national tariffs were introduced for two specialties, and this has been extended in 2006/07 to a total of eight specialties. The impact of tariffs is a major financial pressure for NHS Shetland. Management has recognised this and taken action to quantify the effect and opened negotiations with both the SEHD and NHS Grampian to limit the financial impact.
- 10.39 The outcome of these negotiations has been outlined at paragraph 5.05 to 5.08.

#### **National Shared Services Project**

- 10.40 During the period to January 2007, NHS Scotland has been developing proposals for shared support services in financial and related services in the form of a “hub- and-spoke” model. The response to the proposals, including that from NHS Shetland, was characterised by reservations over the risks inherent in the proposed scheme, the impact on staff and the proposed savings, relative to the level of investment required.

- 10.41 The project has recently been re-launched as the shared support services programme, involving a two-tier approach which seeks to build confidence in new ways of working using common processes and systems, leading to a single services model based on a common finance system. This approach involves a “foundation” level of involvement around common ledger arrangements, or a “pathfinder” approach which seeks to develop more advanced elements. It is envisaged that a national business case for the revised approach will not be available until mid to late 2008.
- 10.42 NHS Shetland has held provisional discussions with NHS Ayrshire & Arran regarding potential Consortium working. NHS Ayrshire & Arran are looking to establish a potential Pathfinder model proposal, within a Consortium of Health Boards, to demonstrate a shared delivery of financial services across a cluster of Boards. These discussions remain on-going.

# 11. Audit Scotland Performance Work



## Audit Scotland

- 11.01 Audit Scotland delivers the independent audit of governance, financial stewardship and performance on behalf of the Auditor General and Accounts Commission. Audit Scotland operates under the Public Finance and Accountability (Scotland) Act 2000.
- 11.02 Audit Scotland has particular interest in studies that examine the quality of public services from the user's perspective. The programme of local performance work also takes account of the views expressed by the Scottish Parliament, the Scottish Executive and other main organisations they work with.
- 11.03 For the 2006/07 financial year, the following reports were published:
- Planning ward nursing – legacy or demand? A follow up report;
  - Overview of the financial performance of the NHS in Scotland;
  - Catering for patients: a follow up report;
  - Managing IT to deliver information in the NHS in Scotland;
  - How the NHS works: Governance in Community Health Partnerships – Self Assessment Tool; and
  - Health and community care bulletin.
- 11.04 Copies of Audit Scotland reports are distributed within the organisation, but to date have not been formally presented to the Audit Committee. . Going forward, all Audit Scotland reports will be presented to the Audit Committee following their publication for consideration and discussion.
- 11.05 Audit Scotland has recently finalised its programme for 2007/08, and this programme has been detailed below:
- Primary care out of hours services;
  - NHS performance and financial overview;
  - Palliative care;
  - New General Medical Services contract;
  - Diagnostic services;

- NHS asset management; and;
- Using medicines in hospitals follow-up.

11.06 The Audit Committee are to be presented with each of these reports on their publication.

**ACTION POINT 14**

# Appendix 1: Action Plan

Ref	Recommendation	Risk Category	Management Response	Responsible Officer	Date of Implementation
1	<p>National tariffs have been implemented across the NHS in Scotland. It is estimated this will result in an additional financial pressure estimated by NHS Shetland management to be £0.62 million at 2007/08 inflation rates.</p> <p>NHS Shetland management have been successful in negotiating with both the SEHD and Grampian NHS Board to reduce the financial impact of the tariff policy on NHS Shetland. It is recommended these negotiations continue to ensure a long-term agreement is reached on the impact of tariffs and ensure stability in financial planning.</p>	High	Agreed.	Director of Finance.	Ongoing.
2	<p>Significant financial challenges remain for the Board. A high level risk assessment for the risks and financial pressures associated with the 2007/08 projections was performed and reported to the Board.</p> <p>In addition, there is a requirement for savings of £0.852 million to achieve financial balance. However, at the time of this report, £0.262 million remains to be identified.</p>	High	The remaining savings of £262,000 have now been identified (as reported to the May 2007 Board meeting). Progress against all savings targets will be reported back to the Board on a regular basis.	Director of Finance.	Ongoing.

Ref	Recommendation	Risk Category	Management Response	Responsible Officer	Date of Implementation
3	<p>The Board again achieved a surplus in 2006/07 and successfully managed the financial pressures during the year. However, there remains reliance on non-recurring measures and an underlying financial deficit in the region of £1.2 million exists. One of these key measures is the annual negotiation with Shetland Islands Council to waive the Revenue Resource Transfer payable by the Board.</p> <p>It is recommended management clarify the position on this issue going forward to ensure stability in financial planning.</p>	High	Agreed. The waiver was agreed in principle in April 2007. The Board will seek to confirm the details by December 2007.	Director of Finance.	December 2007.
4	<p>As part of the National Shared Services initiative, the Board has held provisional discussions with NHS Ayrshire &amp; Arran regarding potential Consortium working with a view to implementing a new financial management system. NHS Ayrshire &amp; Arran are looking to establish a potential Pathfinder model proposal, within a Consortium of Health Boards, to demonstrate a shared delivery of financial services across a cluster of Boards.</p> <p>These discussions remain on-going and it is strongly recommended that management seek resolution of this issue within the 2007/08 financial year.</p> <p>In addition, Management should ensure the level of funding and support provided by the host body and the SEHD, together with staff resources and training is sufficient to ensure successful implementation and the earlier production of year end financial accounts for audit.</p>	High	Agreed. It remains the Board's aim to implement a new general ledger (hosted by NHS Ayrshire and Arran) by December 2007. This will represent a significant challenge (particularly in the light of the recent departure of the Finance Manager). Negotiations are continuing with the Shared Support Services Programme regarding the level of assistance to be provided. However, the Board accepts the need for a new general ledger during 2007/08 irrespective of the funding sources.	Director of Finance.	December 2007.

Ref	Recommendation	Risk Category	Management Response	Responsible Officer	Date of Implementation
5	<p>Due to the limitations on the functionality of the General Ledger, Fixed Asset data is held in a suite of spreadsheets. These spreadsheets hold relevant financial data for Fixed Assets and are used to perform calculations such as depreciation, revaluations, impairments at the year end.</p> <p>Management should ensure that a fixed asset module is included within the new financial ledger package.</p>	High	Agreed. The fixed asset module is included in the suite of modules under discussion with NHS Ayrshire and Arran.	Director of Finance.	December 2007.
6	We would strongly encourage Board management, working with the Scottish Executive Health Department, to resolve the issue of Equal Pay in terms of likelihood and quantification of potential liabilities.	Medium	Agreed. The Board is working with the Scottish Executive Health Department and the Central Legal Office on this issue. In addition, the Director of Human Resources and the Director of Finance are tracking this issue on their national professional networks.	Director of Human Resources.	In line with national policy as recommended by the Equal Pay Unit.
7	Management should ensure that the agreed action plan to address the control weaknesses raised in our Follow-up Report and Interim Management Letter are implemented in accordance with the specified timescales and that progress is reported to the Audit Committee on a regular basis.	Medium	Agreed.	Director of Finance will co-ordinate this.	Updates to be presented to the Audit Committee during 2007/08.



Ref	Recommendation	Risk Category	Management Response	Responsible Officer	Date of Implementation
8	Management should ensure that an appropriate action plan is put in place to address the control weaknesses raised in our final management letter and that progress is reported to the Audit Committee on a regular basis.	Medium	Agreed.	Director of Finance will co-ordinate this.	Updates to be presented to the Audit Committee during 2007/08.
9	Management should ensure that any actions identified by QIS in their forthcoming report are allocated with clear lines of responsibilities and deadlines.	High	Agreed.	Chief Executive.	Action plan to be in place by September 2007.
10	The Board should adopt a formal policy and procedure in relation to the National Fraud Initiative. This should detail the various stages of the process, including accountabilities, deadlines and reporting mechanisms.	Medium	Agreed. The Board is following the procedure set out in HDL(2006)44. It is envisaged that a report will be brought to the November Audit Committee summarising the findings and actions taken.	Director Finance.	November 2007.
11	The Audit Committee has requested that Internal Audit perform a review of the Patients' Travel system and report back to the Committee and we recommended within our interim audit report that all recommendations should be accompanied by a detailed action plan with deadlines and clear accountabilities.	Medium	Agreed.	Director of Finance.	Depends on the timing of the Internal Audit report.

Ref	Recommendation	Risk Category	Management Response	Responsible Officer	Date of Implementation
12	The Service Redesign Committee should continue to oversee and report on the process of re-design to ensure the Hospital Capital Programme is delivered on time, to budget and initial objectives are achieved.	High	Agreed.	Director of Clinical Services.	Ongoing.
13	Management should ensure that there is appropriate profile and resource allocated to achieving the sickness absence target of 4% by March 2008.	Medium	Agreed.	Director of Human Resources.	Ongoing.
14	All Audit Scotland performance reports should be presented to the Audit Committee for consideration	Medium	Agreed.	Director of Finance.	With effect from November Audit Committee.

# Appendix 2: Responsibilities of External Audit and the Board and its Management



The matters dealt with in this report came to our notice during the conduct of our normal audit procedures which we carried out in accordance with the framework and principles contained within Audit Scotland's Code of Audit Practice.

As a result, we may not have identified all the issues and matters that may exist. It is the responsibility of NHS Shetland and its management to maintain adequate and effective financial systems and to arrange for a system of internal controls. To discharge our audit responsibility, we evaluate significant financial systems and associated internal controls and, where appropriate, report to management any weaknesses identified. In practice, we do not examine every financial activity and accounting procedure and we cannot substitute for management's responsibility to maintain adequate systems of internal control.

This report is intended to assist NHS Shetland regarding its arrangements to implement appropriate controls surrounding the production of certain management information and processing systems. The report does not purport to provide information or advice to any person not associated with NHS Shetland and we accept no responsibility to such persons. Specifically, the report should not be interpreted as providing legal advice to NHS Shetland or any other party.

The prime responsibility for the prevention and detection of fraud and irregularities rests with NHS Shetland. It also has a duty to take reasonable steps to limit the opportunity for corrupt practices. As part of our approach, we consider these arrangements but our work does not remove the possibility that fraud, corruption or irregularity has occurred and remained undetected.

It is the responsibility of NHS Shetland and its officers to prepare the Accounts in compliance with statutory and other relevant requirements. We are responsible for providing an opinion on the Accounts.

It is the responsibility of NHS Shetland to put in place proper arrangements to ensure the proper conduct of its financial affairs and to monitor their adequacy and effectiveness in practice. We have a responsibility to review and, where appropriate, report on the financial aspects of the audited body's corporate governance arrangements, as they relate to:

- The legality of transactions that might have significant financial consequences;
- The financial standing of the audited body;
- Systems of internal financial control; and
- Standards of financial conduct and the prevention and detection of fraud and corruption.

It is the responsibility of NHS Shetland to put in place proper arrangements to manage its performance in order to secure economy, efficiency and effectiveness in its use of resources. We have a responsibility to review and, where appropriate, report on the arrangements that NHS Shetland has put in place to secure economy, efficiency and effectiveness in its use of resources.

For more details on any of the issues raised in this document reference should be made to those detailed reports issued by us to NHS Shetland during the year as listed at [Appendix 4](#).

### **Materiality**

Materiality is defined by the International Accounting Standards Board in the following terms:

*“Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends upon the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut off point rather than being a primary qualitative characteristic which information must have if it is to be useful.”*

Overall audit risk and materiality are significant concepts used in determining the extent of audit work.

Guidelines for this organisation suggest that preliminary materiality be set at approximately 1% of total expenditure. However, materiality is not simply a quantitative figure. Qualitative aspects also need to be considered in assessing whether something would be significant to a user of the financial statements.

The final assessments as to what comprises a material error in the financial statements is a matter of judgement and has been made in accordance with ISA320 “Audit Materiality”.

## **Management's Judgments and Accounting Estimates**

Management has the responsibility for applying judgment in preparing the accounting estimates and disclosures contained within the financial statements.

## **Audit independence**

As external auditors of NHS Shetland we are required to be independent in accordance with the Code of Ethics for Professional Accountants issued by the International Federation of Accountants and by the Ethical Standards established by the Auditing Practices Board.

These standards require that we disclose to the members all relationships that, in our professional judgment, may reasonably be thought to bear on our independence.

We confirm that no issues have arisen to impair our independence, objectivity and integrity. We further confirm that we are not presently aware of any relationship or non-audit services that would impair our audit independence.

# Appendix 3: Audit Opinion



## **Independent Auditor's report to the members of Shetland Health Board, the Scottish Parliament and the Auditor General for Scotland**

We have audited the financial statements of Shetland Health Board for the year ended 31 March 2007 under the National Health Service (Scotland) Act 1978. These comprise the Operating Cost Statement, the Balance Sheet, the Cash Flow Statement and Statement of Recognised Gains and Losses and the related notes, but excluding the Directors' Report. 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 for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Respective responsibilities of the board, Chief Executive and auditor**

The board and Chief Executive 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 Chief Executive 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 2006/07 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 Directors' Report 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.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements; the financial statements being the only part of the Annual Report which we have audited. This other information comprises only Directors' Report. 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 2006/07 to be audited. It also includes an assessment of the significant estimates and judgements made by the board and Chief Executive 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 2006/07 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 2006//07 to be audited.

## **Opinion**

### *Financial statements*

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 2007 and of its net operating cost position, total recognised gains and losses and cash flows for the year then ended; and
- the financial statements and the part of the Remuneration Report 2006/07 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.

**PricewaterhouseCoopers LLP**  
**Glasgow**

29 June 2007



# Appendix 4: Other Formal Reports Submitted During the 2006/07 Process



Reports submitted by PricewaterhouseCoopers LLP during the 2006/07 audit process

## Planning visits

Annual Service Plan

## Interim Visit

Follow up of 2005/06 Audit Recommendations

Internal Controls Report 2006/07

## Final Accounts Visit

Audit Opinions

Annual Report to Board Members

Final Management Letter

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