



# NHS Highland

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

For the financial year ending 31 March 2019

Audit Committee and Board 25 June 2019

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# Our financial statements audit at a glance



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



For the financial year ended 31 March 2019, we have issued an unqualified audit report.



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

## An audit underpinned by quality



During our audit we identified one unadjusted audit difference in relation to NHS Highland's recognition of provisions informed by Central Legal Office Information. It is not considered material to the financial statements.



While we received a complete set of financial statements, the Performance Report and Governance Statement were received late in the audit process. Following audit review, a number of changes were made to the Governance statement and Performance Report to better reflect some of the governance and performance challenges faced by NHS Highland.

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# Wider scope conclusions

In accordance with the Audit Scotland Code of Practice we are required to conclude on areas of significant wider scope risk as they relate to financial management, financial sustainability, governance and transparency and value for money.

## NHS Highland - Context

2018/19 has been a very difficult year for NHS Highland. The financial pressures reported in 2017/18 have continued, alongside the Board moving to a level 4 categorisation on the Scottish Government escalation framework. There has been, and continues to be, leadership changes at NHS Highland aligned with a period of increased focus in looking to move the Board towards a more sustainable financial position.

As well as the specific actions taking place to address the financial gap, significant work is in development to re-shape the culture of the organisation, as a direct action from the Sturrock review published in May 2019. NHS Highland publicly acknowledged the organisational failures reflected in the Sturrock report and have agreed an initial action plan with the Cabinet Secretary for Health and Social Care. The level of organisational change set out in the Sturrock report by its very nature will take time, but there is an overriding commitment to improving engagement, openness and transparency throughout the organisation.

## Financial position

In 2018/19 NHS Highland received additional financial support in the form of brokerage of £18million in order to support the organisation in meeting its statutory financial targets. From the start of 2018/19 the Board had been forecasting the need for brokerage between £19 million and £23 million and the financial returns submitted by NHS Highland to Scottish Government set this out. On 10th of May 2019 the exact brokerage amount was confirmed by Scottish Government. During 2018/19 the Board successfully achieved savings in-year of £26.7 million. However, there remained a financial gap as at 31 March 2019.

Areas of financial pressure for NHS Highland continue to be through medical locums, where costs are increasing year on year (circa £16million in 2018/19), adult social care, and increasing drug costs. This is coupled with NHS Highland achieving one-off in year savings due to the number of posts which are vacant or unfilled part-way through the year. The other side of this, is that NHS Highland's performance against the 16 standards set out by NHS Scotland continues to decline, relative to other NHS Boards, in certain cases due to the level of staffing available (capacity) to provide the services required within the standard targets set out. NHS Highland are aware of the cost pressures and are actively seeking to address the areas of costs identified, and take performance improvement actions within the context of ongoing local and national recruitment challenges.

## Financial position – Forward look

In April 2019 NHS Highland submitted a one-year Annual Operating Plan (AOP) to the Scottish Government, with initial estimates over a three-year period. NHS Highland are working on a more detailed three-year financial plan to support further discussions with Scottish Government. The AOP submitted sets out the need for brokerage in 2019/20 of £11.4 million, further brokerage of £6million in 2020/21 and by 2021/22 NHS Highland will achieve the statutory targets without the need for additional Scottish Government funding.

On review of the AOP, recognising the current position in identifying and delivering savings, certain assumptions appear optimistic. NHS Highland are continuing to discuss financial options with the Scottish Government and have agreed as part of the AOP process to submit more detailed financial forecasts by end of July 2019. From our external audit work we can see that the commitment within the Senior Leadership Team to achieve future financial sustainability, is evidenced in the ongoing identification of savings plans, which are more robust than in previous years. However, to deliver all the required savings, recurrently, and be back within the medium term financial planning cycle in three years is an ambitious target based on past history.

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## Leadership

During 2018/19 NHS Highland have continued to operate with several senior roles in the organisation being filled on an interim basis, including the continuation of an interim Director of Finance, following two unsuccessful recruitment processes to recruit permanently to the post, and an interim HR Director (a new permanent HR Director starts in July 2019).

In February the Medical Director announced his intention to retire and will do so formally retire at the end of August 2019. In the period since the announcement, an Associate Medical Director has been acting as the Medical Director.

NHS Highland's Chief Executive announced in July 2018 her decision to leave the organisation in December 2018. Following this announcement two recruitment rounds were followed, but a suitable candidate was not identified. The difficulty to fill senior roles, within the NHS, has been reported as an increasing theme in the NHS Scotland overview report (2018).

Recognising the need to recruit to the post, a different approach was then taken to the recruitment. Applicants, not short-listed on the previous two occasions, were re-reviewed by the Scottish Government Health and Social Care Directorate (SGHSCD). Through this process a potential candidate was identified and formally interviewed. Following this process, a Chief Executive was appointed who joined NHS Highland in February 2019. At the end of February 2019 an interim Board Chair was appointed to replace the Board Chair who resigned with immediate effect. The interim Chair is in post for up to 9 months or until a permanent Board Chair is appointed. This recruitment process is happening now. Given the difficulties within NHS Scotland in appointing Board Chairs we encourage NHS Highland to continue to work with SGHSCD to ensure continuity in this period. Whilst we note the Interim Chair appointed had no previous NHS or Board Chairing experience, he does understand the Highland challenges and is focused on ensuring the Board work collectively together.

It is fully anticipated at this stage that all the proposed leadership changes, as planned for in 2018/19, will be in place during 2019/20 which will give the organisation much needed stability.

## Leadership team re-structure

In May 2019 the Board approved the first phase of a leadership re-structure. This created a post of a Deputy Chief Executive and Director of Corporate Services. This post would be supported by an Operational Director of Finance. A permanent appointment to this post is being sought, using a specialist recruitment agency, with interviews planned for the end of June. As difficulty was experienced in recruiting a Director of Finance, the role has been broadened out to include Corporate Services and the deputy Chief Executive post, allowing NHS Highland to advertise the post at a higher salary than previously.

To provide support to NHS Highland in the interim period, one of the SGHSCD Financial turnaround Directors has been appointed into this role, for a fixed 3-month term. The costs of this appointment are being met directly by SGHSCD and the interim cover is not an employee of NHS Highland.

The Interim Deputy Chief Executive supports the Chief Executive, attends leadership team meetings, attends the Finance Sub-Committee and the Board, but is not a formal appointed member of the Board.

This, in the interim period, has created an unusual governance structure and we would note that the Interim Deputy Chief Executive does not have an employment contract with NHS Highland although we understand they are working to the intended future job specification. This unusual arrangement will be resolved in 2019/20 through the appointment of a permanent Deputy Chief Executive.

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## External Support

There continues to be ongoing discussion with the SGHSCD on NHS Highland's future plans and what support is required, how and when. This is a welcome dialogue with the support helping NHS Highland move forward much quicker, and with more certainty around the future financial plans. NHS Highland's overall intention is to reorganising roles and responsibilities to ensure a greater alignment between quality improvement and achieving financial balance.

Given the challenging financial position, NHS Highland have been working closely with the SGHSCD Head of Financial Recovery. A procurement exercise was run, and in March 2019 the Board approved the appointment of external consultancy support. The contract awarded was to support NHS Highland in creating a Project Management Office (PMO) and to oversee the cross-cutting transformation plans and upskilling NHS Highland staff who were recruited into the PMO. The external consultancy support contract is on a contingency fee basis, and requires NHS Highland to support the achievement of certain objectives. This work is ongoing, with a significant fee to be paid during 2019/20. NHS Highland are paying for this work, and where needed the costs will be met from the brokerage requirements in 2019/20, although this is still being further discussed with Scottish Government. Supporting the creation of the PMO and overseeing the plans is an experienced interim PMO Director. The cost of this support for 6 months is £120,000, and is being paid for by NHS Highland.

At the end of the 6-month period (consultancy and interim PMO) it is anticipated that NHS Highland will be in a place to continue to run the PMO without consultancy support albeit the plan is to advertise for a permanent PMO Director in August 2019. Given the significance of the role and remit of the PMO, in supporting transformation change alongside financial improvements, in our view whilst the intention is recognised this will be challenging and it is important the momentum behind this work does not drop, and work continues to take place on organisational wide buy-in and engagement to the programmes.

## Governance arrangements

Following the good governance pilot Blueprint work in NHS Highland which reported in July 2018, NHS Highland developed an action plan. The action plan was subsequently refreshed in April 2019 following a Board workshop and NHS Scotland self-assessment survey. To date progress against the agreed actions has not been as quick as initially planned, due to the dependency on several of the leadership appointments only being progressed in the later half of 2018/19. Continued focus on the action plan is needed in 2019/20 to support the ongoing governance improvements within NHS Highland and to ensure governance is fit for purpose.

Given the recognised challenges it is important the Board continues to work as a collective, feel able to hold management to account, and to effectively challenge and then support decisions taken. Following on from both the Chief Executive's and interim Board Chair's appointment substantial work has taken place with the Board, particularly through strategic workshops and development sessions. A number of these workshops have focused on improving the Board's understanding of the financial position, and the future transformational plans.

We encourage the Board to continue to seek to learn and develop and note the support they are receiving from NHS Education Scotland on training and development. Alongside the ongoing development we recommend the Board continues to review the skills matrix created in 2018/19 to continue to identify where certain Board members skills and experience would be beneficial, as either a current gap or an area where could be strengthened. We note that the outstanding Board non-executive vacancy which has been in existence for much of 2018/19, alongside two further non-executive roles will be filled in July 2019, supporting the Board's future capacity.

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## Audit Committee

In our experience the Audit Committee needs to be substantially strengthened within NHS Highland's governance structures. There have been developments during 2018/19 to further strengthen the committee, and these should continue into 2019/20. Currently there are 102 internal audit recommendations that are past their due date and outstanding. This has been acknowledged by the Committee as unacceptable and plans have been initiated to address this, and we anticipate this will reduce substantially over the next three months. The Committee should continue to look to how they hold management to account over the delivery of agreed actions within internal audit and other reports they receive. Lastly, there is an opportunity for the Committee and Management to work closer together to increase the quality of the information they receive in order to ensure the committee can fulfil its scrutiny role effectively.

The Employee Director is at present a member of the Committee, making up one of the five non-executive posts. In light of the Scottish Government Audit and Assurance Handbook issued during 2018/19, and the updated UK Corporate Governance Code (2018) this is not considered good practice. We recommend the Committee review whether this is still appropriate in light of the wider Board membership changes and the updated guidance.

The Audit Committee has a role in respect of risk management. Risk management arrangements require improvement, and this has been recognised by the Chief Executive. A review of wider risk management arrangements is planned, including a review of the risk management committee being a sub-committee of the audit committee and its overall current effectiveness.

## Overall conclusion

NHS Highland during 2018/19 faced significant financial, performance, and operational challenges which are well acknowledged by NHS Highland and SGHSCD. We note that substantial work is ongoing to develop a plan to improve NHS Highland's underlying financial performance alongside a period of significant organisational change which will take time, by its very nature, to be implemented. NHS Highland are fully committed to taking positive action, and are being supported in this by SGHSCD.

We can see future plans in place and certain actions which have already taken place, and continue to be ongoing, to make the necessary improvements. However, it is too early to conclude on how successful the mitigating actions will be, until they are further developed and fully established during 2019/20.

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# Contents

<b>Section</b>	<b>Page</b>
1. Introduction	8
2. Our financial statements audit	9
3. Financial management	16
4. Financial sustainability	19
5. Governance and transparency	22
6. Value for money	26
<b>Appendices:</b>	
1. Audit Adjustments	30
2. Action plan 2018/19	31
3. Follow up of 2017/18 recommendations	36
4. Fees, independence and fraud arrangements	37
5. Communication of audit matters	38

# Introduction

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2019.

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

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

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

Our report was presented as a draft to the NHS Highland Audit Committee and then the special Board meeting on the 25 June 2019. Following comments from the Audit Committee this report was updated and re-circulated for information.

We would like to thank NHS Highland management and in particular the Interim Director of Finance and the finance team for an effective year-end audit process and all their support and assistance in the audit during the year.

## Structure of this report

In accordance with the Audit Scotland Code of Practice 2016, in addition to our core financial statements audit we provide conclusions on the four dimensions of wider-scope public audit. Our report is structured as follows:

Financial statements – Section 1

Financial management – Section 2

Financial sustainability – Section 3

Governance and transparency – Section 4

Value for money – Section 5



## Our Opinion

For the financial year ended 31 March 2019 we have issued an **unqualified audit opinion**

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



## The audit process

While we received a complete set of financial statements (numbers) at the start of our audit. The Performance Report and Governance Statement were received late in the audit process, which is understandable given the nature of the issues to be reflected this year.

Following review by external audit, a number of changes were made to the Governance statement and Performance Report to better reflect some of the governance and performance challenges faced by NHS Highland during 2018/19.



## Audit completion

We identified one unadjusted difference, included in this report, to report to the Audit Committee and the Board. We identified minor disclosure adjustments within the financial statements and are satisfied these have been reflected within the financial statements (see Appendix 1).

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# Our financial statements audit



We have issued a true and fair audit opinion on the financial statements, including the wider information contained in the financial statements, and regularity opinion.



As noted in our audit plan, we have updated our materiality assessment to reflect the draft 2018/19 financial statements. Overall (Group and Board) materiality has been set at £9 million (1% of gross expenditure adjusted for IJB transactions) and performance materiality is set at £6.75 million (75% of materiality). We report to management any audit difference identified over £250,000 (Trivial as 5% of materiality).



The draft financial statements were prepared in line with the 2018/19 NHS accounts template. The financial statements were supported through good working papers. Through audit review, there were a number of observations made around enhancing the disclosure in the annual governance statement and performance reports in the front end of the financial statements.



Testing provided assurance on identified areas of significant audit risks and there were no material audit differences arising during the course of our audit. There was one unadjusted audit difference (appendix 1). This is not considered material to the financial statements.

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## Audit approach and materiality

Our audit approach was set out in our annual audit plan presented to the Audit Committee on 18 December 2018. As set out in our plan, our materiality calculations were based on the audited 2017/18 financial statements. As noted in our audit plan, we have updated our materiality assessment to reflect the draft 2018/19 unaudited annual report and accounts. Overall materiality has been set at £9 million (1% of gross expenditure) and performance materiality is set at £6.75 million (75% of materiality). We report to management any audit difference identified over £250,000 (Trivial as 5% of materiality).

While we received a complete set of financial statements, the Performance Report and Governance Statement were received late in the audit process. Following external audit review, a number of changes were made to the Governance statement and Performance Report to better reflect some of the governance and performance challenges faced by NHS Highland during 2018/19.

## Audit opinion

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

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

## Key audit issues – Responding to significant audit risks

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

	Identified audit risk at planning	Work completed	Our conclusion
Risk of fraud in revenue	<p>As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. We consider this funding to be well forecast and directly agreed to Scottish Government funding letter and draw down. We therefore consider the opportunity and incentive to manipulate this revenue stream as low and rebut the presumed risk around revenue recognition. Similarly, funding from services commissioned from the Integration Joint Board revenue from other Scottish Boards is relatively well forecast and agreed to funding letter / inter-Board funding agreements. This reduces the opportunity for manipulation and the inherent risk of material misstatement in revenue recognition. We therefore focus our testing on the 'Other' revenue stream. As financial performance targets are primarily set for year end outturn position, the risk is prominent around year end revenue transactions and balances.</p>	<ul style="list-style-type: none"> <li>• Developed our understanding of NHS Highland's material revenue streams including walkthrough of key transactions.</li> <li>• Performed audit testing of key revenue streams during the year, including analytical procedures and testing of a sample of transaction</li> <li>• Performing revenue cut off procedures and substantive testing over pre and post year end balances with a focus on pre year end transactions recognised in 2018/19 to gain assurance these did not relate to 2019/20 revenue.</li> <li>• Testing the existence and recoverability of receivables balances at the year end</li> </ul>	<p>From our audit procedures performed we are satisfied that revenue is free from material misstatement. We are satisfied that revenue has been recognised in the appropriate financial year.</p>
Operating expenditure is not treated correctly	<p>Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As set out in Practice note 10 (revised) which applies to public sector entities. As payroll expenditure is well forecast and agreeable to underlying payroll systems there is less opportunity for the risk of misstatement in this expenditure stream. We therefore focus on non-pay expenditure. NHS Highland's gross expenditure also includes contributions to the Integration Joint Board. As this expenditure is agreed to funding confirmation we do not consider their to be a significant risk of fraud in this expenditure stream, however the delivery of IJB related services by the Board is considered through payroll and non-payroll costs. We focus our risk on other material expenditure stream including, independent primary care services, drugs and medical supplies, Goods and Service with other private providers and voluntary organisations. As financial performance targets are measured on year end outturn, we consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of non-pay expenditure.</p>	<ul style="list-style-type: none"> <li>• Developed our understanding of NHS Highland's material expenditure streams including walkthrough of key transactions.</li> <li>• Performing targeted review and testing of key expenditure streams during the year, including analytical review of expenditure and targeted transaction testing, including consideration of the regularity of expenditure incurred.</li> <li>• Performing cut-off testing of expenditure transactions around the year end to ensure these had been allocated to the appropriate financial year. Reviewing post year end payments for any potential unrecorded liabilities.</li> </ul>	<p>Assurance gained that expenditure has been recorded within the appropriate financial year and that payables are free from material misstatement. We are satisfied that expenditure has been incurred in accordance with the type/nature of NHS Highland as an organisation</p>

	Identified audit risk at planning	Work completed	Our conclusion
Management override of controls	<p>As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. Override of controls is present in all entities.</p>	<ul style="list-style-type: none"> <li>• Developed our understanding of the entity level controls in place at NHS Highland that reduce the risk of management override</li> <li>• Performed review of journal transactions for unusual transactions or balances.</li> <li>• Evaluated key areas of judgement, including accruals, prepayments and provisions within the Financial statements and the basis for these judgements / application of accounting policies</li> <li>• Reviewed unusual and/or significant transactions</li> </ul>	<p>We did not identify any significant areas of bias in key judgements by management. We have not identified any unusual or significant transactions during the course of the year that would indicate management manipulation.</p> <p>During the course of our audit procedures we identified one unadjusted misstatement with regards provisions. This was due to the Board applying local understanding and knowledge of expected case outcomes rather than following CLO guidance on expected case outcomes.</p>

We did not identify any further areas of significant audit risk of material misstatement during the course of our audit.

### Internal control environment

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

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

No material weaknesses in the accounting and internal control systems were identified based on our work undertaken during the audit which could have an adverse impact on NHS Highland ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. We adopted a substantive based approach to the audit of the financial statements and therefore our review is limited to the design of controls rather than the operating effectiveness of these.

### Internal Audit

As set out in our external audit plan we have not placed formal reliance on the work of Scott-Moncrieff, the internal audit provider, during 2018/19. We have reviewed the internal audit plan and individual reports issued to date, to consider if any impact on our audit approach. For 2018/19, Internal Audit's draft opinion was

*“NHS Highland has an adequate and effective framework of governance, risk management and control, subject to the implementation of the following actions: Across 2018/19, specific improvement actions have been highlighted in relation to aspects of governance (including management oversight, risk management and related to the external governance review findings); ongoing actions in relation to the development and maintenance of a supportive organisational culture; and, there is a need for substantial improvement in the implementation of outstanding audit actions, particularly in relation to higher risk actions.”*

We are satisfied that Internal Audit's overall conclusions are reflected in the governance statement.

## Other key areas of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. Whilst not considered a significant audit risk, these are areas of potentially increased risk due to their complexity or magnitude. This includes areas of key estimation and judgement and application of accounting policies.

NHS Highland's Accounting policies are in accordance with IFRS as interpreted and adapted by the 2018/19 NHS Accounts Manual and we consider these to be appropriate to the organisation. These have been applied consistently compared to prior year with the exception of the adoption of two new accounting standards IFRS 9 and 15. While these resulted in minor disclosure changes to the accounts, neither of these standards had a material impact on NHS Highland's annual report and accounts. Management have recognised the need to review during 2019/20 the contractual terms of Research and Development income deferred at the balance sheet date to continue to ensure the timing of income recognition is appropriate, in accordance with IFRS 15. We note that the balance as at 31 March 2019 was not material to the financial statements.

### Accounting estimates and judgements:

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

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

During 2018/19, NHS Highland continued with the rolling programme of revaluation of 20% of assets held. Other items of PPE were reviewed to ensure they continued to reflect fair value, and indexation applied (provided by the valuer) to reflect market movement in value or impairment applied. We have reviewed the revaluation undertaken in year, including the work performed by external valuer, and through evaluation of movements during the year and challenging Management and the valuer over large or unusual valuation movements, we are satisfied that property, plant and equipment have been appropriately recorded in the accounts. We have considered managements evaluation of assets not subject to independent valuation during the year to ensure that the valuation remains appropriate and that there was no risk of material impairment.

**Clinical and Medical Legal Claims and CNORIS provisions:** NHS Highland provides for Clinical and medical legal claims against the Board. NHS Highland participates in the Clinical Negligence and Other Risk Indemnity Scheme (CNORIS). Under CNORIS, NHS Highland meets the costs of claims up to £25,000. Any amount above this is covered through a pooled CNORIS share made up from contributions from all health boards. Audit Scotland have provided an independent assessment of the suitability of the CLO and a review of the Scottish Government methodology to calculate CNORIS provisions. We have reviewed clinical and medical legal claims and CNORIS provisions. We found that Management overlay the CLO information with local understanding of the claim. While we recognise Management may have local knowledge of the claim, the CLO information reflects independent legal advice. We have raised an unadjusted difference with regards to the calculation of CLO claims. However, we consider the amount recognised to be free from material misstatement. We recommend that Management engage with the CLO in advance of preparation of the CLO final report for the 2019/20 financial year to provide any further local information held on outstanding cases to ensure that the CLO report reflects up to date information. **Action plan point 1**



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

In December 2018, the Court of Appeal ruled that the transitional protection offered to some members of public sector pension schemes as part of reforms to those schemes amounts to unlawful discrimination (known as the 'McCloud' case) The Government is currently seeking permission to appeal this decision, with an unknown time frame for permission to be granted or denied. If permission to appeal is denied or an appeal be unsuccessful, it would likely result in a requirement to compensate certain members for any discrimination suffered as a result of the transitional protections. This could lead to additional liabilities with regards local government pension schemes, including the Highland Pension Fund (HPF).

We consider that the impact of the McCloud case on pension liabilities and should reflect an obligation under IAS 19. Management has recognised the impact as an estimation uncertainty in the defined benefit pension disclosure and has excluded it from the defined benefit calculation. However, we are satisfied that initial estimates of the potential impact on scheme liabilities would not be material to NHS Highland with estimates in the region of 0.5 –3.2% of scheme liabilities (£2.259 million). We are satisfied that the defined benefit scheme liability is free from material misstatement in 2018/19. Looking forward, we recommend that Management engage with the Highland Pension Fund and the Fund's actuary during 2019/20 to ensure any result of this legal case is reflected and provided for where required. **Action plan point 2**

### Going concern

NHS Highland's accounts have been prepared on a going concern basis. While NHS Highland face significant financial challenges in the coming years, these challenges are recognised by the Scottish Government Health and Social Care Directorate (SGHSCD) and summarised in NHS Highland's Annual Operating Plan. On the 17<sup>th</sup> of June the Board received a letter from SGHSCD agreeing the Annual Operating Plan for 2019/20 subject to clarification of financial forecasts, including forecast levels of underfunding by end of July 2019. The Scottish Government has confirmed in this letter that it "*will continue to support NHS Highland in its endeavours to put the Board on a firmer financial footing*".

### Fraud and irregularity

Management have confirmed that there were no material frauds or irregularities during the financial year. Our audit procedures did not identify any indication of fraud or irregularity.

In relation to the audit risk of fraud, our testing of expenditure and revenue during the year as well as sample testing of manual journal entries did not identify any indication of fraud or management override of controls. There are no post balance sheet events which need reflected in the annual report and accounts.

## Narrative elements of your annual report and accounts

We have reviewed the narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding of NHS Highland and the financial statements as a whole and have set out our observations below. We have also audited the required information in the remuneration report (marked audited) and have no matters we wish to bring to your attention.



## Adding value through our external audit work

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

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

We have continued to build on our working relationship with management and our understanding of NHS Highland as an organisation. During the year we have worked closely with management to understand the Board's financial position and support from Scottish Government Health and Social Care Directorate. The Engagement Leader met with the Interim Chair of the Board, the new Chief Executive, the Interim Deputy chief Executive and Interim Director of Finance during the audit, to fully understand NHS Highland's financial and operational challenges.

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# Financial management



While NHS Highland met its financial reporting targets for 2018/19, this was only achieved through in year brokerage of £18 million from the Scottish Government. This reflects the fact that the underlying operating model is currently financially unsustainable.



At the outset of 2018/19, NHS Highland had a budget gap of £50.5 million. Throughout the year, NHS Highland was forecasting deficits against funding (revenue resource allocations – RRL) of between £19 - £23 million. This was primarily due to the challenge in identifying and then the delay in delivering £19 million of savings which were not identified at the start of 2018/19, alongside particular cost pressures.



Currently, the Board's underlying financial position is unsustainable. For 2018/19, NHS Highland faced a budget gap of £50.5 million. While savings of £26.6 million were delivered during 2018/19, £4.9 million of the original £31 million savings were not achieved.

In addition, savings of £9.5 million in the current year were only delivered on a non-recurring basis.

NHS Highland for 2019/20 has a budget gap through undelivered savings of £33 million for 2019/20 and that is before any cost, pay or demand pressures are considered. It is critical that NHS Highland focus on delivering longer term, sustainable savings plans and the plans and processes established during the last quarter of 2018/19 are delivered in 2019/20.

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

In accordance with the Code of Audit Practice, we have undertaken appropriate procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial management arrangements. This included review of financial plans and performance reports.

Identified audit risk at planning (December and January 2019)

Conclusion

The 2018/19 financial plan identified required savings of £50.495 million. By August 2019, only £30 million of the required savings had been identified and there is still considerable risk around the delivery of these savings in year. The Board faces significant operational challenges including service demand, payroll and non-payroll cost pressures as well as delivery of patient care over a disparate population. While in 2017/18 over £35 million savings were achieved, £13 million was on a non-recurring basis.

**Our Response:** We will review the NHS Highland's financial management arrangements including the extent to which there is effective scrutiny over both operational spend as well as delivery of savings plans. Our work will consider the extent to which the performance impact of in year savings is monitored. We will also consider the financial capacity and capability to support good financial governance.

NHS Highland reported a saving against Revenue Resource Allocation of £0.144 million. However, the outturn position was only achieved through the receipt of additional £18 million of financial brokerage from the Scottish Government. Without this funding, NHS Highland would have reported a deficit of £17.9 million for the year.

For 2018/19 the Board identified that £50.495 million of efficiency savings were required in order to break even in year. Savings plans were established at the start of the year for £31.5 million, with £19 million which still required identification, and delivery, during 2018/19..

The Board achieved £26.6 million of savings during 2018/19. The savings were delivered through a range of initiatives in the year. The most significant of which were:

- Cost containment, including vacancy management of £8.7 million
- £2.1 million at Raigmore
- £8.5 million through central regional savings
- £2 million through Argyll & Bute
- £1 million through facilities and ehealth
- £1.1 million in corporate savings

	Limit £'000	Outturn £'000	Variance (over) / under £'000
Core revenue resource limit (RRL)	714,703	714,559	144
Non-core revenue resource limit	27,216	27,216	0
Capital resource limit (Core)	19,675	19,675	0

### Financial planning and monitoring

Financial performance is reported to the Board during the year, and the Finance Sub-Committee and NHS Highland is subject to close financial monitoring by the Scottish Government.

We recognise the forecast overspend, and the need for brokerage, was in line with planned overspend reported to the Scottish Government. However, funding for brokerage support is was not formally confirmed by SGHSCD until 10 May 2019.

### Ability to deliver savings



- Non-recurring savings (£9.5 million)
- Unidentified savings (£19 million)
- Savings not achieved (£4.9 million)

While NHS Highland delivered savings of £26.6 million during the year, the underlying financial performance highlights that NHS Highland will continue to face significant pressures in 2019/20 and beyond. Of the original planned savings, £4.9 million were not achieved during 2018/19. Furthermore, savings of £9.5 million in the current year were only delivered on a non-recurring basis. When taken in the context of required brokerage support of £18 million for the financial year, NHS Highland has a budget gap through undelivered savings of £33 million for 2019/20 before any cost, pay or demand pressures are considered. Therefore, it is critical that NHS Highland focus on delivering longer term, sustainable savings plans and implement the plans established during 2018/19. **Action Plan Point 4**

## Delivery of outturn performance

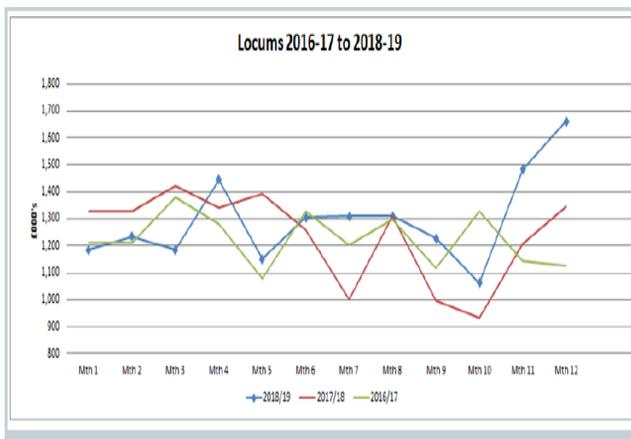
The actual outturn position reflected a number of overspends, payroll underspends and unanticipated benefits during the year.

For underlying pay costs, NHS Highland were underspent by £4.5 million against budget. However, this reflects the level of unfilled vacancies NHS Highland has and potential consequential impact on service performance.

The outturn position also reflected £11.1 million of non-payroll related overspends. These relates to:

- Drug costs (hospitals and prescribing) overspend by £3.6 million
- Clinical non-pay costs overspent by £1.3 million
- Social Care costs associated with service demand and cost pressures - overspent by £4.3 million and
- Other service performance overspends of £1.9 million

Area	Under / (Over) spend £ million
Pay underspend	4.5
Non-payroll related operational expenditure	(11.1)
Undelivered savings	(4.9)
Offsetting benefits and additional income	12.6
Unidentified savings from the start of the financial year	(19)
Brokerage	18
<b>Outturn</b>	<b>0.1</b>



## Locum costs

As in previous years, NHS Highland has continued to experience difficulties in recruiting to some key clinical posts in both primary and secondary care. This has led to continued expenditure in the year in respect of medical locum services of circa £15.6 million, an increase from £14.9 million in 2017/18 and £14.7 million in 2016/17. While we note that staff costs, including locum costs, are below budget, the locum costs represent a significant area of financial expenditure and do not fully address the vacancy pressures experienced by NHS Highland. A key focus for NHS Highland is reducing the pressures on vacancy management, ensuring that NHS Highland has the appropriate workforce in order to ensure the provision of safe clinical care.

## Capital expenditure

NHS Highland received capital funding for the year of £19.675 million. NHS Highland has reported a breakeven position against capital resource limit for 2018/19. In line with NHS Highland's capital programme, the majority of the capital expenditure related to £6 million investment in Raigmore (theatres and critical care). Other areas of expenditure included £2.2 million on radiotherapy replacement programme and £2.1 million funding backlog maintenance.

Through review of minutes and the capital programme, we have observed that NHS Highland manage capital investment in line with available funding. We are satisfied that capital programme continues to be closely monitored by the Board and investments controlled to within available finance.

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# Financial sustainability



NHS Highland's underlying operating model is currently not financially sustainable without significant changes to service delivery and potentially provision. This is recognised by the leadership team and the Board. Over £39 million of savings are required for 2019/20, with the Board requiring support via brokerage of a forecast £11million in 2019/20 and a further £6million in 2020/21. In 2018/19 the Board rolled out a programme of "grip and control" to better control spend and this will continue into 2019/20.



In November 2018, the Scottish Government escalated NHS Highland to level 4 within the ladder of escalation and additional support measures and initiatives have been put in place to assist the Board in its aim of returning to financial balance.

Under these arrangements, additional strategic support has been provided to NHS Highland. A Transformation Team, reporting to SGHSCD, has been established to support the Board through this process with the establishment of Programme Management Office (PMO). In addition, NHS Highland has commissioned external consultants to provide support in identifying, delivering savings and embedding the PMO.



PricewaterhouseCoopers (PwC) are providing specialist advice and support around delivery of savings and the development of the PMO over a six month contract. Whilst we can see the active development of financial savings plans, and wider cross-cutting transformational plans it is too early to comment on whether these will be successfully delivered and lead to the financial savings required. There is a risk, without external support (either from consultants and/or SGHSCD) the pace of change may not continue, and the PMO will not have the suitable skills and capacity to support the change programmes.

In order to achieve the required transformational change NHS Highland cannot work alone and will need government and public support to implement all desired service changes.

Within our audit plan we identified risk around financial sustainability at NHS Highland. In accordance with the Code of Audit Practice, we have undertaken appropriate procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial sustainability.

Identified audit risk at planning

NHS Highland faces significant financial challenges. Underpinning the financial pressure is that the Board do not have a sustainable operating model. While significant savings have been delivered these are not sufficient to meet the levels needed. We raised concerns in our 2017/18 annual audit report and this cumulated in the Auditor General for Scotland issuing a report highlighting concerns on NHS Highland's financial sustainability under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000.

During 2018/19, the Board has forecast that it will require between £19-£23 million of brokerage and approximately £16 million in 2019/20 to break-even. While the Scottish Government has proposed that the Board will not be required to repay brokerage as at 31 March 2018, this does not address the underlying challenge facing the Board that the operating model is unsustainable

**Our Response:** We reviewed the financial plans in place, including the scenarios set out, the governance of the plans and regular reporting on future financial scenarios. We assessed the progress made by the NHS Highland in developing financially sustainable operating plans that continue to support the delivery of the NHS Highland's statutory functions and strategic objectives.

Conclusion

**NHS Highland continues to face significant financial challenges**

For 2019/20, NHS Highland's Annual Operating Plan forecasts a funding gap of £39.4 million. Management has estimated that it can deliver £28 million of savings and will therefore require a further £11.4 million of brokerage funding required to meet financial targets. In addition, Management has estimated that a further £6.1 million of brokerage will be required in 2020/21 before forecasting a breakeven position in 2021/22. These estimates do not include any potential required repayment of brokerage received, as this has not yet been discussed and agreed with SGHSCD.

	2019/20 £ m	2020/21 £ m	2021/22 £ m	Audit consideration
Net uplift	54.7	28.1	33.1	Remains considerable uncertainty around future levels of funding
Pay, prices and pressures	(61.2)	(42)	(53)	Assumptions appear optimistic with limited transformation costs assumed.
<b>Net in-year savings targets</b>	<b>(6.5)</b>	<b>(13.9)</b>	<b>(19.9)</b>	
Savings unidentified from 2018/19	(19)			
Non-recurring savings brought forward	(5)	(3.7)	(3)	Between 2020 and 2021 the assumed level of carry forward of undelivered savings appears optimistic compared to the Board's past experience in delivering recurring savings. In addition, each year delivery of further efficiencies and savings becomes increasingly challenging.
Undelivered savings brought forward	(8.9)	(11.5)	(5.3)	
<b>Total savings requirement</b>	<b>(39.4)</b>	<b>(29.1)</b>	<b>(28.2)</b>	
Identified savings	28	23	28.2	Based on consideration of funding and expenditure assumptions and limited level of detailed planned savings, at this point in time, the assumed breakeven position by 2021/22 appears optimistic.
<b>Forecast outturn (forecast brokerage)</b>	<b>(11.4)</b>	<b>(6.1)</b>	<b>0</b>	

NHS Highland's financial forecasts include some key assumptions including:

- The net uplift in 2019/20 is higher than 2018/19 due to an increased uplift in baseline funding from Scottish Government, one-off additional £14.5 million of funding in 2019/20 to support employers pension uplift, and uplift of £6million in adult social care funding.
- 2.6% uplift in baseline funding from the Scottish Government (2.2% in 2020/21 and 2021/22)
- Funding will be received for the additional support and turnaround costs.
- Cost pressures include pay uplift assumptions under the agenda for pay 3 year deal as well as forecast superannuation increases.
- Increases of approximately £9 million per year associated with primary and secondary care drugs costs based on horizon scanning information
- Between £8 - £9 million per annum increases in adult social care costs reflecting National home Contract settlement
- Other inflationary and demand driven cost pressures.

In addition to the assumed brokerage funding in 2019/20 and 2020/21, in order to meet financial targets over the next three years, NHS Highland will need to deliver savings of £79.2 million over the coming three years, including £28 million in 2019/20.

We note that compared to prior year, the financial saving plans are greater developed, and a more rigorous process is in place to identify savings, alongside challenge of delivery. However, the savings currently forecast over the next three years are significant and certain assumptions appear optimistic. We note that SGHSCD has asked for revised financial forecasts at end of July 2019, as part of the AOP process. At this stage there remains risks around ownership and actual delivery of planned savings, that the NHS Highland has the capacity and capability to continue the transformation through to delivery. (See **Action Plan Point 4**)

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## Financial capacity and capability

NHS Highland has operated with an interim director of finance since July 2017. During the year additional senior leadership and transformational support has been received from the Scottish Government. This has included the Scottish Government Head of Financial recovery and an experienced finance professional, with turnaround experience. Neither of these individuals are contractually employed by NHS Highland. As a result there may be a risk around lines of accountability and ownership of delivering transformation programmes, alongside how this is sustained in the future. Given the financial challenges facing the organisation it is key that they deliver on the plans in 2019/20 to move to more permanent solution, including the recruitment of the Director of Corporate Services.

We recognise that the finance team will be key to delivering the required transformation, alongside the PMO. The finance team is small and we recommend actions are taken to review succession planning given at least one member of the finance team retiring during 2019/20, and ensure that this team is of a sufficient size, with sufficient capability and capacity to support the ongoing work at NHS Highland. Operational financial capacity will be just as key as strategic financial support and direction. **See Action Plan 5**

## Transformational savings

In November 2018, the Scottish Government escalated NHS Highland to level 4 within the ladder of escalation and additional support measures and initiatives have been put in place to assist the Board in returning to financial balance. Health boards are considered at Level 4 where there is “significant risks to delivery, quality, financial performance or safety” and where senior level executive support is required.

Under these arrangements, additional strategic support has been provided to NHS Highland. A Transformation Team has been established to support the Board through this process with the establishment of Programme Management Office (PMO) alongside financial recovery expertise. NHS Highland commissioned external consultancy support in March 2019. PricewaterhouseCoopers UK LLP (PwC) are providing specialist advice and support around delivery of savings and the development of the PMO over a six month contract. PwC have been contracted on a contingent fee arrangement, and a final fee will be agreed based on delivery of services and agreed outcomes. We understand that the cost of the PwC support is significant, and this will be met by NHS Highland via brokerage from Scottish Government, although this is subject to ongoing discussion.

Over the longer term, there is a significant risk that NHS Highland will not have the skills, capacity or capability to continue to progress and realise the savings plans developed by PwC and the SGHSCD Turnaround support or develop and utilise the PMO framework established. It is essential that alongside the investment in initial PwC support, NHS Highland further invests in ensuring that it has the necessary capacity and capability to implement the transformation programmes agreed. **Action Plan Point 6**

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# Governance and transparency



In May 2018 NHS Highland were the pilot for the good governance NHS Scotland wide governance review. The pilot in May 2018 provided the Board with a comprehensive set of actions in order to improve NHS Highland governance and address the gaps identified. The Board in April 2019 refreshed the action plan. From review of the action plan completed in August 2018 and the combined one in April 2019 we note limited progress in implementing certain of the agreed actions due to the dependency on filling leadership posts. Given the gaps identified we anticipate greater focus on this during 2019/20, particularly given the leadership posts will be filled and the new Board appointments made. By implementing the agreed actions to the NHS Highland governance structures will be strengthened.



Alongside the Chair of the Board, a number of senior positions on the Board are filled on an interim basis including the Director of Finance position, and the Medical Director position as at June 2019. In addition, the interim Deputy Chief Executive is not an employee of NHS Highland and there is no formal arrangement between NHS Highland and the Scottish Government for their services.

Given the challenges faced by the organisation, it is important that NHS Highland has clear lines of accountability and responsibility within the organisation. With the number of interim appointments, as well as members of the senior management team who have no formal contractual arrangement with NHS Highland, there is a risk that there will not be stable leadership in place, with clear accountability to make the difficult decisions NHS Highland will face in the coming years.



In November 2018, the Cabinet Secretary for Health commissioned an independent review following allegations of Bullying and Harassment in NHS Highland. The review, undertaken by John Sturrock QC, was published in May 2019 (The Sturrock Report) and found that bullying or inappropriate behaviour has occurred within NHS Highland. The Board has recognised short comings in the way it dealt with the issues raised and an initial action plan has been submitted to the Cabinet Secretary and agreed.

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

#### Identified audit risk at planning

The Board continues to face significant challenges with regards the recruitment and retention of key staff, particularly those in senior positions. The Board has yet to appoint a permanent Director of Finance and the Chief Executive leaves the organisation in December 2018. Effective leadership will be critical for the Board over the coming years to deliver high quality patient care on a financially sustainable basis.

There is a risk that the Board does not have robust and effective governance arrangements in place to ensure robust and effective oversight and scrutiny of the delivery of statutory and strategic priorities.

**Our Response:** We considered, through discussions with management and review of minutes, NHS Highland's overarching governance arrangements. We considered the progress made by the NHS Highland in implementing the agreed actions from the recent governance review.

#### Conclusion

##### Governance

An independent review of governance arrangements at NHS Highland was undertaken by John Brown CBE, Chair of NHS Greater Glasgow & Clyde and Susan Walsh OBE, Non Executive Director, Healthcare Improvement Scotland. The review was commissioned by the then Chair of NHS Highland as a pilot for wider review of governance arrangements across Scottish health boards. The review concluded in May 2018 and reported to the Chair of NHS Highland and Scottish Government. The review made identified a number of areas where effectiveness of NHS Highland's corporate governance arrangements could be enhanced. These were: Setting the strategic direction; holding to account; assessing risk; influencing culture; engaging stakeholders; skills, experience and diversity; roles, responsibilities and accountabilities; values, relationships and behaviours; assurance information systems; audit services; and, administration arrangements. Following the review, an action plan was developed with dates for implementation. The Audit Committee were responsible for reviewing progress against the dates and highlighting slippage, but overall the Board are responsible for overseeing the implementation of the action plan.

Following the publication of the NHS Scotland: Blueprint for Good Governance in January 2019, NHS Highland undertook a self-assessment against the Blueprint, and identified further areas for enhancing governance arrangements. These findings have been consolidated with the independent review findings to develop an action plan to address the recommendations from both publications has been produced by NHS Highland.

Certain progress has been made against the agreed actions. However, now the leadership team and Board will be fully in place during 2019/20 it is anticipated that the pace of implementation will increase and that during 2019/20 all agreed actions will be implemented. **Action Plan Point 6**

The Quality and Sustainability Plan, established in 2017, describes the national and local strategic context, and the challenges faced by NHS Highland and plans to address these. However, Management recognise that this is primarily focused on the delivery of care, rather than a broader strategic plan for NHS Highland, including longer term financial strategy. As NHS Highland are going through a period of transformation, it will be critical that there remains a focus on the Board's key strategic priorities. We anticipate that during 2019/20 an overarching strategic plan will be established which consists of clinical, financial, workforce plans.

#### Sturrock Review

In November 2018, the Cabinet Secretary for Health and Social Care commissioned an independent review following allegations of bullying and harassment in NHS Highland. The review, undertaken by John Sturrock QC, was published in May 2019 (The Sturrock Report) and found that bullying or inappropriate behaviour has occurred within NHS Highland and the Board has recognised shortcomings in the way it dealt with the issues raised. An initial plan has been provided to the Cabinet Secretary giving details of immediate actions the Board has taken/plans to take in respect of the recommendations made in the Sturrock report. This includes establishing a small senior management group that will steer and be responsible for delivery of meeting the actions identified, including emerging national guidance on whistleblowing. Further reports in 2019/20 will be made to the Board on progress and the development and implementation of plans, including extensive staff engagement which is planned to confirm the initial action plan developed. Currently these plans are only under development and it is therefore too early to conclude on whether these will address the issues identified.

The Sturrock report highlighted that the Board must prioritise being able to hold senior executives to account and should review its structures, committee network and culture. Allied to this the board may wish to oversee a review of the management structure to ensure this remains fit for purpose. This has started with a phase 1 redesign which was approved in May 2019 with a phase 2 planned for discussion and approval during 2019/20. The report also highlighted the importance of appropriate skills and capability across the Board and that there should be a review of Board appointments, together with training and support for all non-executive directors, acknowledging that this may need to incorporate the Scottish Government into the review process to ensure that more generally governance arrangements are appropriate, including ensuring that candidates have the skills, knowledge and expertise to be able to serve on boards. **Action Plan Point 8**

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## The Audit Committee, scrutiny and Internal audit

The Audit Committee play a crucial role in overseeing audit recommendations and in supporting effective scrutiny and challenge. While the Sturrock report did not cover the Audit Committee, it did highlight that its effective functioning is clearly crucial. From attendance at Audit Committees and review of committee minutes, we found that there are opportunities to enhance scrutiny and governance arrangements.

In particular, that the Committees challenge of management is not always as effective as it could be, and the quality of information presented to the Committee does not always support scrutiny. An example of this is the failure of Management to close outstanding internal audit actions in a timely manner. As at May 2019, NHS Highland had 102 open Internal Audit recommendations. During the latest follow up over half of the responsible managers had not responded to Internal Audit. Outstanding audit recommendations can indicate areas of potentially significant risk to the Board and where the controls are not, in place, designed or operating effectively over these risks. It is therefore critical that the status and importance of internal audit recommendations, internal audit and the audit committee are clearly articulated.

During 2018/19, the Scottish Government updated Assurance and Audit Committee Handbook, as well as the UK Corporate Governance Code (2018) were published. Both documents highlight how members of an Audit Committee should be both independent and objective. Currently the Employee Director is a member of the Audit Committee and, as an employee, would not be considered independent, in light of the definition in the UK Corporate Governance code. Therefore, there is an opportunity for the committee to consider whether it has the skills, capability and experience across its membership to provide the required independent review. **Action Plan Point 7**



## Risk management

In May 2018, NHS Highland were the pilot for the good governance NHS Scotland wide governance review. The pilot governance review and resultant action plan identified gaps in NHS Highland's approach to risk management. NHS Highland currently have an established risk management group which is a sub-committee of the Audit Committee. This is an unusual arrangement and we recommend that is revisited in the wider context of the planned risk management changes. Overall there is an opportunity for a greater focus by NHS Highland's on strengthening its approach to risk management to ensure fit for purpose, in particular in terms of the identification of strategic risk, the focus on mitigating actions and ensuring a risk management culture exists across the organisation. The needed improvements to risk management have been identified by the Senior Leadership team and additional risk management support is being considered for 2019/20. **Action Point 9**



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## Fraud and Irregularity

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

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

We found NHS Highland's arrangements for participation in the NFI exercise during 2018/19 to be satisfactory. The Board has effective arrangements in place for the submission of data and investigation of potential matches.



## EU Withdrawal

There is considerable uncertainty around the potential impact of Brexit. Likely areas to impact NHS Highland are: workforce implications; funding; and regulation. We have used Audit Scotland's planning guidance to evaluate the Board's readiness for EU withdrawal across workforce (People and Skills); Finance; and Regulations.

NHS Highland has recognised that EU Withdrawal could have significant implications for the organisation. With its functions and responsibilities being entrenched within legislation, there could be significant consequences from the departure from EU regulations. NHS Highland has established a Brexit Group and has progressed planning arrangements across both workforce and medical supplies as part of National lead programmes. There are opportunities for further evaluation of the threats of EU withdrawal and Board readiness for the potential implications of the UK's exit from the EU. Overall we conclude that NHS Highland is partly prepared for EU withdrawal, reflecting the progress made by the Board and the ongoing risks faced with regards the uncertainty surrounding EU withdrawal.

Management recognise that there remains considerable risk and uncertainty around the full potential implications. However, Management keep these under continuous focus.



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# Value for money



From review of performance information we found a number of issues with the completeness and accuracy of the performance information used by NHS Highland, which were recognised by the Board in May 2019. In particular, management recognise that performance information is incomplete and that baseline targets had not been established to allow critical evaluation of performance in the year. In addition, concerns have been raised around the integrity and accuracy of the underlying performance information. This is an area of focus for the PMO as it oversees transformational programmes and relies on the completeness and accuracy of data.



NHS Highland has seen decline in its performance against the NHS Scotland standard operating standards. . Of targets identified in the annual Operating Plan for 2018/19 the Board were achieving less than 25% of the targets in year. In addition, the Annual Operating Plan underlying savings plans notes that if the financial challenges identified are to continue, to deliver services as is, then further investment would be required to improve service performance.



During 2018/19 both NHS Highland and Highland Council appointed new Chief Executives. Both Chief Executives have reiterated their commitment to review the Lead Agency partnership agreement to re-look at how parties can support the model to make it a success. The agency model is due to be reviewed and agreed during 2019/20 and the Council has agreed to fund a joint post to specifically support the leadership of the Lead Agency model.

## Identified audit risk at planning

Given the financial and operational pressures facing the Board, the efficient and effective use of resources is critical. Managing these pressures can divert focus and resources on strategic use of resources and longer term financial planning. With emphasis on short term deliverables, decisions may fail to consider longer term implications and value to the organisation.

### Our Response:

We considered NHS Highland's performance management framework and how they capture and measure performance and outcomes. We considered the extent to which performance reporting is clear and provides measurable indicator of delivery against targets and that performance information incorporates board wide and operational unit performance. We also considered progress against the key strategic corporate plans and how this is being reported and monitored including how the organisation engages and works with key partners works with key partners.

## Conclusion

The Board has a range of indicators in which it measures performance against the Annual Operating Plan. Across 23 non-financial indicators, four did not have target information and therefore not possible to assess performance. Of the remaining 19, we found that the position reported to the Board in May 2019 highlighted that the Board were only achieving 26% (5) of the local or national targets.

### Performance indicators



Source: May 2019 Performance report to NHS Highland Board (Excluding 2 Financial Performance Indicators)

From review of performance information we found a number of issues with the completeness and accuracy of the performance information used by NHS Highland. In particular we found:

- As at May 2019 four out of twenty three indicators did not have key benchmarks or targets on which to assess performance during the year, although we recognise for these indicators monthly trend is reviewed;
- Concerns have been raised at the Board around the completeness and accuracy of the underlying performance information
- While performance information was reported during the course of the year to NHS Highland Board, we found the focus of performance reports did not always clearly focus on underlying performance issues.

During 2018/19, the Board has developed baseline data to support performance management. As the Board develop a Project Management Office (PMO), which has been supporting data cleansing to enhance the completeness and accuracy of performance information. Complete, accurate and timely performance information is critical to support effective scrutiny of performance and management decision making. **Action Plan Point 10**

## Performance issues – openness and transparency

There were several areas where the Board's performance fell below target and actions plans are in place to address these, although it is acknowledged that in several areas service redesign is required in order to enhance performance to meet the desired standard levels. Across some of the key Scottish Government treatment time targets, we found the following areas where the Board failed to meet performance targets during the year:

- NHS Highland failed to fully meet treatment time targets set by the Scottish Government. In elective care, as of March 2019, 54.4% of patients were treated within the 12-week target specified as compared to a national average of 68.4%. This has been affected by reduced capacity due to major upgrading works to theatres at Raigmore Hospital which are due to be complete in January 2020.
- In relation to cancer treatment waiting times, NHS Highland performance in relation to cancer treatment waiting times was 92.7 % for the month of March 2019, compared to the National position of 95.7% (in respect to the 31-day Standard for the time taken from the decision to treat to the first treatment).
- In relation to the 62-day Standard for the time taken from urgent referral of suspected cancer to first treatment, NHS Highland has achieved 69.4% compliance in March 2019 compared with the national average of 81.6%.

In the context of significant financial pressures, service delivery and performance will come under increasing pressure. Over a period of significant change it is increasingly important that performance is subject to robust, efficient and effective scrutiny (see **Action Plan Point 10** above).

NHS Highland has undertaken a detailed review of performance trends across the organisation to understand areas of pressures and how these could be addressed, including the level of financial investment required and impact this would have on performance. The analysis identifies some common areas of challenge in delivering performance including enough resources, particularly specialist resources to meet service demand. Across each of these areas' recovery plans are in place and details of how additional funding resources will be utilised.

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## Investing in the model of care

NHS Highland recognise the need to continue to develop and transform services to meet the increasing demands of the population of the Highlands, whilst delivering a financially sustainable model of care. To deliver this, the Board has a range of capital investment programmes underway to deliver the infrastructure required to support this change.

In March 2019, the Full Business Case for the planned Elective Care Centre in Inverness was approved by the NHS Highland Board in March 2019 and has now received Planning Permission from The Highland Council. The development is in partnership with the University of the Highlands & Islands and Highlands & Islands Enterprise, aimed at delivering a different model of care through research, development and local innovation. It will play a major part in ensuring that elective care can be provided all year round.

NHS Highland are also looking to invest in the development of Badenoch and Strathspey community hospital in Aviemore which will see the redesign of health and social care services in the area. The redesign involves the closure of Ian Charles Community Hospital (Grantown-On-Spey) and St Vincent's Community Hospital (Kingussie) with a new build Hospital and Medical Centre based in Aviemore, where the GP Practice will be co-located. At the same time, and following engagement with local communities in Skye, Lochalsh and South West Ross, plans have moved ahead for the replacement of the hospital in Broadford with a new purpose-built Community Hospital incorporating A&E facilities and expanded bed capacity. This is an innovative non-"By-Pass" A&E supported by Rural Practitioners (RPs) and supports the move towards bringing care closer to local people. The Badenoch & Strathspey and Skye redesigns are bundled together as part of a capital funded Hub project and it is expected that work on the new community hospitals will commence in summer 2019 with a capital investment of around £40 million.

This investment demonstrates a positive commitment in service redesign. However, by its very nature these projects will take time to develop and delivery anticipated benefits to service users and NHS Highland and will not contribute to an improved financial position in the short term.

## Partnership – Lead Agency Model

Under the partnership with the Highland Council, NHS Highland are the lead agency for integrated adult services and Highland Council is the lead agency for the delivery of integrated children's services.

During 2018/19 both NHS Highland and Highland Council appointed new Chief Executives. While the arrangements face considerable pressures, both Chief Executives have reiterated their commitment to review the Lead Agency partnership agreement to re-look at how parties can support the model to make it a success. This review is due to be completed in 2020 and we will consider this in our 2019/20 external audit.

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# Appendices

**Audit adjustments**

**Action plan 2018/19**

**Follow up of 2017/18 recommendations**

**Fees, independence and fraud arrangements**

**Communication of audit matters**

# Audit adjustments

## Uncorrected and corrected misstatements

During the course of our audit we identified one uncorrected misstatement. This is set out below, and is recognised to be an area of judgement, and is not considered material to the annual report and accounts.

Item	Dr (£'000)	(Cr) (£'000)	Description
Provisions - CLO	450		
1 CLO Receivables		(450)	<i>Being an adjustment to recognise clinical negligence and injury claims in accordance with CLO report and NHS Accounting Manual Guidance. (Note includes corresponding assumed amount recoverable through CNORIS scheme)</i>

## IAS 19 Estimation

NHS Highland's IAS 19 actuarial valuation as at 31 March 2019 did not factor in the potential implication of the McCloud case. While we consider this to reflect an obligation under IAS 19, Management has recognised the impact as an estimation uncertainty in the defined benefit pension valuation and has not factored into the net liabilities calculation. While we do not have an exact measure of the potential impact material to NHS Highland, we are satisfied that current estimates in the region of 0.5 –3.2% of scheme liabilities would not be material to NHS Highland (£2.259 million).

## Significant Disclosure recommendations

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

Disclosure omission	Detail	Adjusted
Updated disclosures around	We recommended disclosure adjustments to enhance disclosures around Board members remuneration including disclosure of all non-executive remuneration. Pension information was outstanding for one Executive Member of the Board as information was outstanding from SPPA at the date of signing	✓
Outturn performance information	Notes to the financial statements required updating including accounting policies with regards those accounts which were new in the current year and impact on the financial statements	✓
Lease disclosures	Adjustments to reflect future lease costs within the financial statements	✓
Corporate Governance statement	Disclosures amended to provide greater clarity around governance issues and action plans in place in response to these	✓

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# Action plan for 2018/19

We have set out below, based on our audit work undertaken in 2018/19, those risks and recommendations we consider are of a higher risk to NHS Highland that Management may wish to consider in the future.

Recommendation	Agreed management response
<b>1. Clinical and Medical Legal Claims and CNORIS provisions</b> We recommend that during 2019/20 Management continue to liaise with the CLO to ensure that local intelligence and information is taken into account within the CLO assessment and report, and that the CLO report reflects the most accurate position of outstanding claims as at 31 March 2020.	Management response: Agreed  Action owner: Technical Accountant Timescale for implementation: Ongoing – end of March 2020
<b>2. Defined benefit pension scheme</b> Management should discuss with Highland Pension Fund the impact of the McCloud case and any resultant decision on the IAS 19 report for 2019/20, to ensure any future liability is captured in the pension liabilities.	Management response: Agreed  Action owner: Head of Area Accounting Timescale for implementation: Ongoing – end of March 2020
<b>3. Performance Report</b> The Board's strategic report and performance report should be further reviewed in 2019/20 to ensure that it fully captures the outcomes NHS Highland are delivering, and "tells the story" of the year, in a way that is meaningful and understandable to the user of the annual report and accounts. This could include enhanced performance information, covering national and local performance standards that are set.	Management response: NHS Highland will improve the strategic & performance reports for 2019/20, seeking out examples of good practice from other areas to assist in this'  Action owner: Director of Communications and Director of Finance Timescale for implementation: 2019/20 Reports

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# Action plan for 2018/19

## Recommendation

## Agreed management response

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### 4. Savings plans

As agreed with SGHSCD, NHS Highland should continue to develop detailed savings plans and refresh the AOP Financial assumptions by the end of July 2019. As planned the focus should be on recurring savings, and savings which are achievable in year and then over the three year period to support the Board back into a balanced financial position. Plans should be in place to continue the work of the PMO and the wider engagement in identifying and delivering savings, so this continues in the absence of SGHSCD support.

Management response:  
NHS Highland is on track to provide SGHSCD an updated to the financial assumptions within the AOP by the end of July.

The formation of a financial recovery programme board to lead the recovery process will ensure that the work of the PMO continues and is embedded within the organisation.

Action owner: N/A

Timescale for implementation: N/a

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### 5. Finance capacity

We recommend finance continue to look at ensuring they have sufficient capacity to support the transformational agenda, recognising one team retirement in 2019/20 and the relative size of the current team, which is small compared to the size of the Board and the challenges we have outlined.

Management are extremely conscious of capacity shortfalls and succession planning issues within the current team. Work has already begun on redesign of the finance structure with the expectation of increasing capacity and minimising the risk of future and potential changes in staff.

Action owner – Director of Finance

Timescale for implementation: Autumn 2019

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# Action plan for 2018/19

## Recommendation

### 6. Leadership and capacity - PMO

NHS Highland should continue to focus on staffing (internally or externally) the PMO function and ensuring the future PMO has the skills and capacity to oversee the financial transformation programmes and that the momentum established in 2018/19 does not dip.

### 7. Governance arrangements

NHS Highland should continue to progress the implementation of the blueprint action plan and in particular should ensure there is not further slippage against the planned timescales and the necessary improvements are put in place, and operate effectively during 2019/20.

## Agreed management response

### Management response:

The PMO and associated processes are already well established and working well with support from PWC. NHS Highland recognises the potential risk of both capacity and skills lost when the PWC contract comes to an end. Active recruitment has already begun with some success. Further, to add capacity staff members from the existing KPO team are transferring to the PMO to enhance capacity further. Recruitment to a permanent PMO Director is being actively pursued.

**Action owner:** Deputy Chief Executive  
**Timescale for implementation:** Sept 2019

### Management response:

NHS Highland is committed to implementing the actions contained within the Action Plan associated with the Blueprint for Good Governance. A number of development and training sessions are already planned for 2019 to fulfil the actions identified, and revised board induction processes are to be trialled with the whole board.

**Action owner:** Board Secretary  
**Timescale for implementation:** Ongoing during 2019/20

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# Action plan for 2018/19

## Recommendation

## Agreed management response

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### 8. Governance – Audit Committee

The membership of the audit committee should be reviewed in light of the revised Scottish Government Assurance handbook and the UK Corporate Governance code. In addition, the Committee should take forward the planned actions around overseeing the implementation of internal audit recommendations so there is a marked improvement in progress alongside agreeing with management the future quality of the information submitted to the Committee to support the Committee in fulfilling its role effectively.

#### Management response:

The membership of the audit committee will be reconsidered in light of the Scottish Government Assurance Handbook and the UK Corporate Governance Code. The Audit Committee will track and invite Internal Audit sponsors to report on progress to future meetings and ensure better Leadership Team engagement.

**Action owner:** Board Secretary & Chief Executive

**Timescale for implementation:** during 2019/20

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### 9. Risk management

The Board's arrangements in respect of risk management should be strengthened in 2019/20. In particular, the identification of strategic risk, the mitigation of the risks identified, the overall risk management framework and then the role and remit of the respective governance committees related to risk. The planned increase in risk management support and capability should also be introduced in 2019/20.

The Board is to hold a Strategic Risk Management workshop in August 2019 to help with consistency of understanding the board's responsibilities and leading to a refreshed risk register and risk appetite statement. NHS Highland is also committed to recruiting a dedicated Risk Manager during 2019-20 to strengthen its capability for risk management.

**Action owner:** Chief Executive

**Timescale for implementation:** during 2019/20

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# Action plan for 2018/19

## Recommendation

## Agreed management response

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### 10. Performance information

From review of performance information we found a number of issues with the completeness and accuracy of the performance information used by NHS Highland. In particular we found:

- A number of key performance indicators did not have key benchmarks or targets on which to assess performance during the year;
- Concerns have been raised around the completeness and accuracy of the underlying performance information
- While performance information was reported during the course of the year to NHS Highland Board, we found the focus of performance reports did not always clearly focus on underlying performance issues.

The agreed actions in respect of the underlying completeness and accuracy of the performance should be progressed, as agreed, and regular updates provided to the Board and respective committees during 2019/20.

### Management response:

*Report will be changed to show where improvement on baseline is target. NHS Highland has a strong focus on data quality and additional resource in the form of additional data quality officers currently being recruited will help address these issues. Format of reports to ensure underlying issues are clear will be agreed with the Board.*

**Action owner:** Director of Strategic Commissioning  
Planning and performance

**Timescale for implementation:** Dec 19

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# Follow up of 2017/18 recommendations

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During 2017/18 in response to correspondence received by Audit Scotland, we undertook a review of procurement arrangements at NHS Highland. An action plan was developed in response to the findings of this review. To allow us to validate that the actions and controls taken by management have embedded within NHS Highland, we have excluded these from our prior year follow up and will follow these actions during our 2019/20 audit.

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## Follow up of 2017/18 External Audit Recommendations

## Action as at June 2019

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### Financial management

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

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

### Superseded

Annual Operating Plan for 2019/20 includes three year financial plan to deliver financial balance. However, there is a lack of detailed plans to support the delivery of the required level of savings needed to achieve financial balance.

See Action Plan for 2018/19

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### Financial sustainability and performance

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

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

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

### Superseded

See Action Plan for 2018/19

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### Internal Audit Recommendations

It is critical that management address control deficiencies or gaps identified by Internal Audit where these represent a significant risk to the organisation in a timely and proportionate manner. We recommend that Management review the outstanding recommendation and ensure that there is clear ownership and accountability around the implementation of these. This may require reassessment of agreed actions and implementation dates to ensure these are deliverable and appropriate. Management may look assess whether any outstanding recommendations have been superseded or are not considered a significant risk and therefore an area of priority for the Board.

### Outstanding.

As at May 2019 there are still over 100 outstanding internal audit recommendations. It is critical that management, liaising with Internal Audit, undertake a comprehensive review of these to ensure that they remain valid outstanding actions and have not been superseded.

Management response:

Action owner:

Timescale for implementation:

# Fees, independence, fraud arrangements

## External Audit Fee

Service	Fees £
External Auditor Remuneration	152,145
Pooled Costs	16,950
Contribution to Audit Scotland costs	8,700
Contribution to Performance Audit and Best Value	0
<b>2018-19 Fee</b>	<b>177,795</b>

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

The above fee has not changed and our final fee was £177,795.

## Fees for other services

Service	Fees £
We can confirm there are no non-audit fees for the 2018/19 financial year	Nil

## Independence and ethics

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

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

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

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

We can confirm no independence concerns have been identified.

## Fraud arrangements

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

As part of our audit work we are responsible for:

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

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

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

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

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

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

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

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

# Communication of audit matters

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

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

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



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