

Financial Review

- The Board achieved all three of its financial performance targets. (see 2.1)
- The underlying financial position for 2004/05 demonstrates a recurring deficit of £1.3m. (see 2.3)
- The Board have prepared a balanced budget for 2005/06 following a rigorous review of developments and risks. This included a savings plan of £1.3m. (see 2.4)

Financial Statements

- Our opinion on the financial statements is unqualified. (see 3.1)
- Our opinion on regularity is unqualified. (see 3.3)

Corporate Governance

- Our opinion on the Statement of Internal Control is unqualified. (see 4.1)
- A new "Priorities and Risks Framework" audit planning tool has been introduced this year. A summary of our "position statement" report is at 4.2.

Performance Audit

One study was completed in the year:

- Staff Governance. Our report concluded that improvements have been made in the collection and reporting of information. (see 5.3)

Action Plan

Two recommendations are made:-

- The Board should continue to monitor the risks associated with the financial plan for 2005/06. (see 2.4)
- the Board should monitor progress in each of the key risk areas highlighted in the Priorities and Risks Framework report. (see 4.2)

Acknowledgement

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

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

The purpose of the financial review is to consider the general financial standing of the Board by looking back at financial performance in 2004/05 and to look ahead to the future financial position. Our review is aimed at helping Board members understand the financial position of the Board at a particular point in time. It should not be regarded as definitive or comprehensive and the Board should not seek to rely on this summary in isolation.

Contents:

- **Financial Objectives 2004/05**
- **Performance against budget 2004/05**
- **Underlying Financial position 2004/05**
- **Financial Plan 2005/06**

2.1 Financial Objectives 2004/05

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

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

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

The Cash Requirement is a financing requirement to fund the cash consequences of the ongoing operations and the new capital investment.

The table below summarises the Board's performance and shows that the Board achieved each of the three targets.

	Target £'000	Outturn £'000	Achievement
To remain within the RRL	36,074	36,050	Yes
To remain within the CRL	2,872	2,794	Yes
To remain within the Cash Requirement	36,945	36,521	Yes

2.1 Financial Objectives 2004/05 (cont'd)

The Board is to be commended in meeting its targets.

The 2004/05 budget was set in April 2004 on the assumption of a total RRL of £33.062m. This was supplemented by:

	£m
Original Budget	33.062
A transfer of resource from the capital resource limit to the revenue resource limit of £0.75m.	0.750
A carry forward from the underspend of the previous year of £0.33m.	0.330
Additional allocation for the Highlands & Islands Travel Scheme of £0.521m.	0.521
Additional funding to meet increased capital charges arising from the revaluation of £0.331m	0.331
Various additional allocations principally in respect of primary care services of £1.08m.	1.08
Final RRL	36.074

These additional funds were mainly utilised in meeting the increased costs during the year arising from:-

- the new GP contract - £0.76m
- increased cost of the agenda for change implementation - £0.278m
- the new "out of hours" arrangements - £0.277
- increased pension contributions - £1m

2.2 Performance against budget

The Board set a budget of £33.062m in April 2004. This included an amount identified as reserves of £0.25, leaving a planned expenditure of £32.812m.

As explained in the previous section (2.1), this figure was amended during the year as further developments and actions were funded from SEHD.

	£m
Original Budget	32.812
Additional Approvals:	
• Hospital and Community	1.486
• LHCC	0.664
• Miscellaneous initiatives	0.223

Budget at February 2005	35.185

Additional earmarked allocations	0.480

	35.665

Net expenditure per accounts	36.050

Ovespend to be met from reserves	0.385
Reserves	0.408

Surplus per accounts	0.023
	=====

The Board are to be commended for containing expenditure within their overall budget.

2.3 Underlying Financial position

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

Some areas of expenditure are effectively fully funded by the SEHD, based on the actual spend. (referred to as “non-discretionary”). These include patients travel expenses, and elements of Family Health Service (FHS) expenditure.

These are generally referred to as non-recurring, in the sense that they are not part of the core funding, although this type of funding can stretch over two or three financial years, and does occur on an annual basis.

The following table illustrates this by analysing the funding and expenditure for 2004/05. For the purpose of the table we have separately identified the non recurring income and expenditure which is expected to be available over a longer period than in one financial year (long-term), from “one off” non-recurring items.

2.3 Underlying Financial position (cont'd)

Shetland NHS Board	£'000	£'000
Recurring income	27,831	
Recurring expenditure	-29,176	
Underlying recurring (deficit)		-1,345
Non-recurring income (long-term)	7,013	
Non-recurring expenditure (long-term)	-6,974	
Balance of non-recurring (long-term)		39
2004/05 funding gap		-1,306
Other income sources		
Non-recurring SEHD income	1,230	
Corporate savings programme	100	
Total other income		1,330
Financial surplus for 2004/05		24

This illustrates that the Board faces a recurring funding gap of £1.3m. As reported at 2.4, the Board have approved savings plans to release that sum of resources.

2.4 Financial Plan 2005-2006

The anticipated final resource limit revenue allocation for 2005/06 is £36.748m, an increase of £0.67m from the final position in 2004/05.

An initial summary financial plan for 2005/06 was submitted to the Board in March 2005. This informed the Board of the initial revenue resource allocation and highlighted the requirement from the Scottish Executive for efficiency savings of 1% per annum in each of the years 2005/06, 2006/07 and 2007/08.

However, the Director of Finance highlighted a number of financial pressures for 2005/06 including:-

- Pay uplift —£0.458m
- Full year effect of agenda for change —£0.71m
- Prescribing and hospital drugs —£0.27m
- Additional capital charges —£0.314m
- Other non pay inflation —£0.436m

The Director of Finance, at that stage forecast a shortfall of approximately £1.3m, after taking into account a proposed transfer of resource from capital to revenue of £0.75m.

2.4 Financial Plan 2005-2006 (cont'd)

Shetland NHS Board	£'000	£'000
Recurring income	29,779	
Recurring expenditure	- 32,136	
Underlying recurring (deficit)		- 2,357
Non-recurring income (long-term)	6,969	
Non-recurring expenditure (long-term)	- 5,916	
Balance of non-recurring (long-term)		1,053
2005/06 funding gap		- 1,304
Other income sources		
Non-recurring SEHD income	0	
Corporate savings programme	1,304	
Total other income		1,304
Projected financial surplus/(deficit for 2005/06)		0

2.4 Financial Plan 2005-2006 (cont'd)

A further report to the Board in April 2005 confirmed that savings of approximately £1.3m would require to be made to balance the budget for 2005/06. However, the Director of Finance reported that plans were either in place or under development to meet this target.

Of this total of £1.3m of savings £0.247m is considered to be non recurring.

The Director of Finance highlighted however, that a number of risks remained:-

- the final figure in respect of agenda for change had not yet been established.
- final allocations of resource from the Scottish Executive had not yet been confirmed.
- the planned savings were not yet fully realised.

Recommendation

The Board should continue to monitor the risks associated with the financial plan for 2005/06.

The respective responsibilities of the Board, and Tenon Audit Limited are summarised in Appendix 2. The purpose of this section of our report is to highlight and explain our formal opinion on the financial statements, and to comment on the main issues arising from our audit of the financial statements.

Contents:

- **Audit Opinion**
- **Timetable and procedures**
- **Regularity Opinion**
- **Issues for this year**
 - **Indexation and Revaluation of Fixed Assets**
 - **Agenda for Change**
 - **Prior Year Adjustment**
- **Local Health Council**

3.1 Audit Opinion

We have issued an unqualified audit opinion and report on the accounts of Shetland Health Board for the year ended 31 March 2005.

A copy of our audit opinion is attached to this report as Appendix 1.

3.2 Timetable and Procedures

The deadline for submission of audited accounts to the Scottish Executive Health Department (SEHD) is 31 July.

We commenced our audit of the final accounts to 31 March 2005 on 13 June, as agreed with the Board. The timetable for the production of the annual accounts is extremely tight. In order to achieve these deadlines the accounts preparation procedures require good planning, commitment, and resources.

We discussed plans for the preparation and audit of the accounts with the Director of Finance in April 2005. The Board's timetable scheduled production of the first draft of accounts by 3 June.

SEHD developed a summarisation spreadsheet package to facilitate the preparation and audit of the NHS consolidated accounts. Auditors have to form a view as to whether the contents of the spreadsheet for their Board are a true reflection of the final audited accounts, and issue an audit report to that effect.

3.2 Timetable and Procedures (cont'd)

A first draft of the Board's accounts using their own version of the summarisation spreadsheet template was received by us on 8 June 2005. The first draft of the published accounts including all narrative statements, was received on 30 June 2005.

Our audit was substantially completed by 8 July and a closedown meeting was held with the Director of Finance on 21 July 2005.

A copy of the final version of the summarisation spreadsheet was received by us on 25 July 2005.

The accounts were approved by the Audit Committee on 21 July and by the NHS Board on 26 July. Our audit was formally concluded on 29 July, within the SEHD deadline.

3.3 Regularity Opinion

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

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

To meet this requirement we need to:-

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

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

3.3 Regularity Opinion (cont'd)

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

Although issues remain in respect of Patient Exemption Fraud/Error (see 4.3), and the new GP contract system (see 4.3), we are pleased to confirm that we have issued an unqualified opinion on regularity.

3.4 Issues for this year

Indexation and Revaluation of Fixed Assets

The complete NHS Estate in Scotland was revalued at 31 March 2004.

In order to avoid the difficulties experienced last year the SEHD have decided on a rolling five year programme of revaluations. This means that 20% of the NHS Estate in Scotland will be revalued each year. Indices from this will be used to estimate the effect each year on the remaining 80%.

The whole of the Shetland Health Board estate was selected for revaluation in the first year of the new approach. This produced a valuation of £21.8m at 31 March 2005, an increase of £1.7m.

Agenda for Change

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

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

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

3.4 Issues for this year (Cont'd)

Agenda for Change (Cont'd)

The Board have estimated a cost of £0.278m for the period 1 October to 31 March 2005 and this figure is included in the accounts.

Prior Year Adjustment

As part of the revaluation at 31 March 2004, the partially completed Brae Health Centre was included in the valuation, at cost of £0.5m. In finalising the accounts this was added to Land and Buildings, but was already included in "Assets under Construction".

This had no impact on Operating costs. This has now been corrected in the accounts to 31 March 2005, and is disclosed in Note 28 to the accounts.

3.5 Local Health Council

The Accounts of the Shetland Local Health Council are included as note 8 of the Shetland Health Board Accounts and show total expenditure of £53,000. We are required to attach a separate audit certificate on these accounts. There are no qualifications to our opinion.

Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. The respective responsibilities of Shetland Health Board and Tenon Audit are summarised in Appendix 2.

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

Contents:

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

4.1 Statement of Directors' Responsibility in Respect of Internal Control

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

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

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

- Financial
- Operational
- Compliance
- Clinical Governance

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

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

Risk Assessment and Management has therefore become a critical element of planning, managing and control. The Board have in place a Risk Management Policy and a risk register.

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

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

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

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

4.2 Priorities and Risks Framework

Introduction

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

The PRF is a comprehensive document identifying approximately seventy risks and a similar number of audit issues over a range of eight topics. The PRF will be refined and revised and used to plan future audits commencing 2005/06.

Audit Approach

We met with the Chief Executive, and the Director of Finance, to discuss the full PRF document and obtain senior management’s view of the key risks and issues. We also sought their assessment of where Shetland Health Board stood in relation to the issues, recognising that these were in the main, emerging issues and it was not therefore expected that completed action would be in place in all cases.

We also reviewed a range of evidence and supporting documentation in order to assist in our own assessment. For 2004/05 we considered that it would make best use of the tool to identify the key risks for Shetland Health Board from the document and agree with the senior management team a position statement in respect of those risks which will enable future monitoring. A commentary on each of the eight key themes appears opposite.

4.2 Priorities and Risks Framework (cont'd)

Priorities and risks Framework (PRF)	Commentary
Governance	The Board maintains a Corporate Governance Handbook containing all the relevant documentation. The Board need to clarify their approach to Corporate level risks.
Service Sustainability	A vision document has been prepared. The Board now need to complete the development of strategies to achieve that vision.
Financial Management	The Board have three-year balanced plans in place. However, they recognise the need to re-establish the budget basis and improve monitoring at budget-holder level.
Performance Management	The Board have a comprehensive Corporate Action Plan which is monitored and reported quarterly. The quarterly performance monitoring report needs to be reviewed and refreshed.

4.2 Priorities and Risks Framework (cont'd)

Priorities and risks Framework (PRF)	Commentary
Pay Modernisation	Project Plans are in place for each area of Pay Modernisation. However, there are no formal systems in place to measure and monitor service improvements arising. Work is underway, however, on a "Benefits Realisation" report.
Workforce Management	A "baseline" report has been completed. However, there is no comprehensive "Work Force Plan" which identifies requirements over the medium to long term.
Joint Futures	Progress has been made with joint appointments and a Local Implementation Plan. Actions in the plan need to be more specific, time bound and measurable.
Information Management	The ehealth strategy needs to be finalised, costed, resourced and an action plan implemented. Business continuity plans for GP premises are in place, but not for hospital sites.

4.2 Priorities and Risks Framework (cont'd)

A report expanding on specific risks in each area has been submitted to the Chief Executive.

We would recommend that the Board use this to monitor their progress in each of these areas.

Recommendation

The Board should monitor progress in each of the key risk areas highlighted in the Priorities and Risks Framework report.

4.3 Primary Care Income and Expenditure

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

Within Shetland Health Board this accounts for approximately £10.37m of expenditure (approximately 26% of gross operating costs). We have reported in previous years on the difficulties in implementing an effective payment verification procedure in respect of this expenditure, and potential income.

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

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

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

4.3 Primary Care Income and Expenditure (cont'd)

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

A quality payment system was introduced which relies on a national software system (QMAS) to calculate the quality "score" for each practice on which payments are based.

The payment Verification Protocol was revised to take account of the new method of payments for GPs but this was not issued to Boards until March 2005, although interim guidance had been issued in October 2004. This protocol states, "The principal method of validating payments made under the QOF is via an annual practice visit". Board staff have carried out practice visits, and this guidance has been followed.

The CSA service auditors (Internal Auditors) produce a comprehensive report on the controls in operation over Primary Care expenditure made on behalf of Boards. However, for 2004/05 this did not include the QMAS system. (We understand that this is included in the 2005/06 programme of work)

4.3 Primary Care Income and Expenditure (cont'd)

Patient Exemption Fraud / Error

The results of the patient exemption checks for Shetland Health Board for the 12 months ended 31 December 2004 were made available to Directors of Finance in February 2005. Patients can claim exemption from charges in respect of three service streams.

- Dental
- Ophthalmic
- Pharmaceutical

Patient Exemption checks are carried out by the Counter Fraud Service of the CSA. The results of their findings have been reported to the Board, analysed by exemption category (44in all) and by the number of cases investigated, the number where repayment has been made, and the number where the result has been inconclusive and the amounts involved have been written off. The CFS extrapolate the results to project the number and value of fraud claims for Shetland Health Board. This is summarised in the table below. As can be seen, this extrapolation suggests that the loss of income due to fraud or error in the Shetland area is in the region of £23,703.

4.3 Primary Care Income and Expenditure (cont'd)

Patient Exemption Fraud / Error (cont'd)

EXTRAPOLATED LOSS OF INCOME

	Shetland %	£	All Scotland %	£
Dental	0.4%	720	4.3%	2,750,012
Ophthalmic	5.7%	4,470	2.7%	969,137
Pharmaceutical	1.0%	18,513	2.0%	8,987,141
		23,703		12,706,290

This extrapolation in Shetland, however, should be viewed with caution. The percentage error rate in Ophthalmic continues to be higher than the national average, contrary to the other two service streams. This arises because 5 of the 64 cases examined (out of a total population of 5,057 claims) were found to be fraudulent.

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

4.4 Internal Audit

Our relationship with Internal Audit is governed by the Auditing Practices Board Statement SAS 500 "Considering the work of Internal Audit".

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

Whenever possible we use the work of the internal auditor to assist us in our assessment of the effectiveness of the internal controls in the Board's main financial systems. However, to enable us to rely on the work of Internal Audit, we need to be satisfied that the audit work has been properly planned, controlled, performed, recorded and reviewed in accordance with the NHS Internal Audit Manual and SAS 500.

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

In 2004/05 we placed reliance on assignments carried out by Internal Audit in the following areas:-

- Budgetary Control
- Accounts Payable
- Income and Debtors

4.5 Management Letters

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

Our draft interim management letter was submitted to the Board on 2 March 2005, and agreed on 11 May 2005.

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

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

4.6 Other Governance responsibilities

Prevention and Detection of Fraud and Irregularities

The respective responsibilities of the Board and ourselves as auditors as set out in Appendix 2. During the year, we reviewed the Board's arrangements in respect of I.T. and made a recommendation in our Interim Management Letter for improvements.

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

Legality

Again, the respective responsibilities of the Board and ourselves as auditors are set out in Appendix 2.

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

Standards of Conduct, Integrity and Openness

We reviewed the Board arrangements in 2003/04 which include:-

The Code of Conduct for Non-Executive Directors as part of the Corporate Governance handbook

- A Register of Directors' Interests
- Provision of appropriate training

We are satisfied that these arrangements are satisfactory.

4.6 Other Governance responsibilities (cont'd)

Financial Position

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

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

We are satisfied that these arrangements are generally satisfactory.

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

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

Contents:

- **Introduction**
- **2004/2005 Performance Audit Programme**
- **Staff Governance**

5.1 Introduction

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

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

5.2 2004/05 Performance Audit Programme

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

Each National Health Study Report is now laid before the Audit Committee of the Scottish Parliament. This changed environment in which performance audit is now conducted has raised the profile of Health Studies considerably.

The strategy for reporting on Health Performance Audit is:

- to establish a baseline report with data and key performance indicators for tracking change
- after 18-24 months, a national follow-up study will be conducted which will name individual bodies (i.e. the "Name and Shame" policy).

It is essential therefore that when data is being collected for performance audit studies, it is based on high quality data and a consistent standard has been applied in collecting evidence.

We have agreed the factual content of our reports with you.

5.2 2004/05 Performance Audit Programme (cont'd)

These national reports undergo a lengthy clearance procedure at national level, and are required to be submitted to the Audit Committee in accordance with the agreed timescale. Local reports form the main source of the national reports. It is particularly important, therefore, that an agreed local report is delivered within the agreed timescale.

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

- Using medicines in hospital
- Review of bowel cancer services
- Whole systems approach to discharge
- Review of colorectal cancer services

Audit Scotland also design a number of performance audit studies which are conducted nationally by the local auditors. This year the only study in that category was Staff Governance.

Although these studies are organised nationally it is important, in our view, that they are tailored to your Board's specific needs. To this end we develop a project brief for each study which lays out terms of reference and which is discussed with management before the studies are undertaken.

5.3 Staff Governance

The NHS in Scotland Staff Governance Standard was launched in 2002. It introduced the third component of governance, combining with financial and clinical governance to complete the governance framework within which NHS Boards and Special Health Boards are required to operate.

The aim was to raise the profile of people management in the NHS in Scotland, and improve accountability by putting the spotlight on how staff are managed and how they feel they are managed in the largest employing organisation in Scotland. This involved audited bodies reviewing their own HR practice to ensure that it met the requirements of the standard. The output from the original self-assessment process was an agreed, credible action plan. This year's study revisited the action plan and validated the actions taken to date. It also reviewed the current year's self assessment process and actions identified for the 2005/06 action plan. There was also a requirement, to provide Audit Scotland with various sets of Mandatory Statistical Information (MSI) for benchmarking purposes.

Our assessment indicated that:

- Last year's action plan was being delivered in part
- The completed actions were resulting in the desired outcomes
- The self assessment process was robust
- The action plan was credible and owned.

5.3 Staff Governance (cont'd)

The information required for the six sets of MSI is now routinely collected at Shetland Health Board, and reported to the Partnership Forum

The local report was issued in March 2005.

Para Ref	Recommendation	Responsible Officer	Agreed Action	Timescale
2.4	The Board should continue to monitor the risks associated with the financial plan for 2005/2006.	Director of Finance	Agreed. The Finance Monitoring Report now includes a specific section on financial risks.	Ongoing
4.2	The Board should monitor progress in each of the key risk areas highlighted in the Priorities and Risks Framework report.	Chief Executive	Agreed. The Audit Committee will monitor the framework on the Board's behalf.	Ongoing

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

We have audited the financial statements on pages A1.0 to A4.0 and N1.0 to N28.0 under the National Health Service (Scotland) Act 1978. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain fixed assets, and in accordance with the accounting policies set out on pages N1.0.

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

Respective responsibilities of the Board, Accountable Officer and Auditor

As described on pages 9 and 10 the Board and the Accountable Officer of Shetland Health Board are responsible for the preparation of the financial statements in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder. The Accountable Officer is also responsible for ensuring the regularity of expenditure and income. The Board and Accountable Officer are also responsible for the preparation of the Directors' Foreword. Our responsibilities, as independent auditors, are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice approved by the Auditor General for Scotland, and guided by the auditing profession's ethical guidance.

We report our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder and whether, in all material respects, the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. We also report if, in our opinion, the NHS Board has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We review whether the statement on pages 11 and 12 complies with the guidance issued by the Scottish Executive Health Department 'Corporate governance: Statement on Internal Control'. We report if, in our opinion, the statement does not comply with the guidance or if it is misleading or inconsistent with other information we are aware of from our audit. We are not required to consider whether the statement covers all risks and controls, or form an opinion on the effectiveness of the NHS Board's corporate governance procedures or its risk and control procedures.

We read the other information published with the financial statements and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinions

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice, which requires compliance with relevant United Kingdom Auditing Standards issued by the Auditing Practices Board.

An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income shown in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Board of Shetland Health Board and the Accountable Officer in the preparation of the financial statements and of whether the accounting policies are appropriate to the Board's circumstances, consistently applied and adequately disclosed.

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

Opinions

Financial statements

In our opinion the financial statements give a true and fair view of the state of affairs of Shetland Health Board as at 31 March 2005 and of its net operating cost, total recognised gains and losses and cash flows for the year then ended and have been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder.

Regularity

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

Tenon Audit Limited
10 Ardross Street
Inverness

July 2005

Risk Assessment

The Board's Responsibility

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

This includes:

- Completion of a Statement on Internal Control (see 4.3)
- Management of exposure to Medical and Clinical negligence claims
- Maintenance of systems of internal control

The Role of Tenon Audit Limited

In planning our audit, we consider and assess your risk management arrangements as part of our assessment of audit risk. This helps us to tailor our audit plans so that they are both appropriate to your circumstances and directed to the areas of greatest risk. We also complete a review of these arrangements as part of our final accounts audit work relating to the Internal Control Statement (see 4.3).

Systems of Internal Control

The Board's Responsibility

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

Three components of the system of risk management are:

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

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

Systems of Internal Control (cont'd)

The Role of Tenon Audit Limited

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

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

We have made suggestions for improvements to procedures where appropriate, in management letters (see section 4.5).

The systems reviewed were as follows:

- Control Environment
- Regularity
- Fraud and Corruption Procedures
- In-Year Reporting (IA)
- General Ledger and Control Accounts (IA)
- Computers and IT
- Cash and Bank
- Accounts Payable (IA)
- Leased Cars
- Primary Care
- Debtors
- Corporate Governance
- Asset Register
- Evaluation of Internal Audit

Systems of Internal Control (cont'd)

The Role of Tenon Audit Limited (cont'd)

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

Prevention and Detection of Fraud and Irregularities

The Board's Responsibility

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

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

The Role of Tenon Audit Limited

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

Legality

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

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

Standards of Conduct, Integrity and Openness

The Board's Responsibility

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

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

The Role of Tenon Audit Limited

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

Financial Position

The Board's Responsibility

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

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

Financial Position (cont'd)

The Role of Tenon Audit Limited

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

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

Financial Statements

It is the responsibility of the Shetland Health Board to:

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

We are required to give an opinion on:

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

In carrying out this responsibility we provide reasonable assurance that, subject to the concept of materiality, the financial statements:

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

Corporate Governance

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

- Openness
- Integrity
- Accountability

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

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

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

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

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

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

SHETLAND HEALTH BOARD

**YEAR ENDED 31 MARCH 2005
FINAL REPORT OF THE EXTERNAL AUDITORS
TO THE MEMBERS OF SHETLAND HEALTH BOARD AND THE
AUDITOR GENERAL FOR SCOTLAND**

JULY 2005

Tenon audit

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

Our audit of Shetland Health Board for the year ended 31 March 2005 has been carried out in accordance with statutory requirements and follows the practices prescribed by the Code of Audit Practice. The Code of Audit Practice sets out fully the responsibilities of the Board and its officers in relation to financial probity, control, preparation of accounts and the achievement of value for money in the provision of services. We are required under the Code to give an independent assessment of how the Board has discharged its stewardship of public funds. A summary of our responsibilities is contained in Appendix 2.

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

This report may contain personal information and information, the disclosure of which, would be prejudicial to our commercial interests as defined in the Freedom of Information (Scotland) Act 2002. In the event that disclosure of this report, or part of this report, is sought we request that we should be consulted before any disclosure is made.

We have summarised the Key Issues arising from our audit in Section One. In providing the summary, it can be difficult to strike a balance between recognising good performance when achieved and highlighting scope for improvement. The items referred to represent Key Issues for management attention and should not be taken out of the context of the remainder of this report, or the detailed reports covering individual reviews. Our responsibilities are explained in our separate "Audit Responsibilities" document and are summarised in Appendix 2.

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

Tenon audit

Summary of how we have discharged our audit responsibilities

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

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