NHS Education for Scotland

Annual Report to Members



Contents

Section	Page
1. Executive Summary	1
2. Introduction	3
3. Independent Auditors' Report and Key Financial Targets	5
4. Financial Performance 2006/07	7
5. Forecast Financial Position for 2007/08	10
6. The Audit Process and Accounting Issues	14
7. Systems of Internal Control	16
8. Governance Arrangements	18
9. Prevention and Detection of Fraud and Irregularities	21
10. Other Business Matters	23
Appendix 1: Action Plan	27
Appendix 2: Responsibilities of External Audit and NHS Education for Scotland and its Manager	ment 28
Appendix 3: Audit Opinion	30
Appendix 4: Other Formal Reports Submitted During the 2006/07 Audit Process	33



PricewaterhouseCoopers LLP Kintyre House 209 West George Street Glasgow G2 2LW Telephone +44 (0) 141 248 2644 Facsimile +44 (0) 141 242 7481 www.pwc.com/uk

The Members of the Board NHS Education for Scotland 2nd Floor Hanover Buildings 66 Rose Street EDINBURGH EH2 2NN The Auditor General for Scotland Audit Scotland 110 George Street EDINBURGH EH2 4LH

28 June 2007

Our ref: LP/EW

Ladies and Gentlemen

Annual Report to Board Members 2006/07

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

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

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

Yours faithfully

PricewaterhouseCoopers LLP

1. Executive Summary

Our Audit Opinion

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

Financial Targets and Performance

1.05 NES' performance against its three financial targets was as follows:

Financial Targets	Achievement
Net resource limit should not exceed the Revenue Resource Limit ("RRL")	NES spent £343.285 million against its RRL of £356.405 million, resulting in a surplus of £13.12 million.
Capital Resource Limit ("CRL")	Total capital spend was £99,000 against a CRL of £99,000.
Cash Requirement Target	NES' cash spend during 2006/07 was £344.907 million within the cash requirement target of £344.907 million.

- NES achieved a £13.12 million surplus for the year, compared to the surplus of £10.4 million projected at the beginning of the year. It should be noted that NES carried forward funding of £10.4 million from 2005/06 resulting in an in-year surplus of £2.72 million over the annual allocation.
- 1.07 NES is projecting an underspend of £13.9 million for 2007/08.

1.08 Further detail about performance in 2006/07 and planned performance in 2007/08 is given in Sections 4 and 5 of this report.

The Audit Process and Accounting Issues

- 1.09 The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided and internal review process undertaken by management were of a good standard.
- 1.10 We are required to report any unadjusted errors to those charged with governance. All adjustments identified from the audit process have been agreed and adjusted by management.

Systems of Internal Control

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

Governance Arrangements

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

Prevention and detection of fraud and irregularities

- 1.14 Our work on the prevention and detection of fraud and irregularities included:
 - review of NES' overall arrangements for the prevention and detection of fraud and corruption;
 - consideration of NES' arrangements in respect of the National Fraud Initiative (NFI);
 - review of fraud guidance issued by Audit Scotland and the Scottish Executive Health Department (SEHD); and
 - submission of an annual fraud return to Audit Scotland.
- 1.15 Further details of all these matters are set out in Section 9.

Other Business Matters

- 1.16 As part of our audit, we have obtained and documented certain information relating to NES in a number of areas including business risks and relocation.
- 1.17 A summary of this work is set out in Section 10.

2. Introduction



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

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

Acknowledgements

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

3. Independent Auditors' Report and Key Financial Targets

Our Audit Opinion

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

Financial Targets

3.06 NES' performance against its three financial targets was as follows:

Financial Targets	Achievement
Net resource limit should not exceed the Revenue Resource Limit ("RRL")	NES spent £343.285 million against its RRL of £356,405 million, resulting in a surplus of £13.12 million.
Capital Resource Limit ("CRL")	Total capital spend was £99,000 against a CRL of £99,000.
Cash Requirement Target	NES' spent £344.907 million during 2006/07; this complying with the cash requirement target of £344.907 million.

3.07 The actual out-turn for the year was a surplus of £13.12 million, compared to the surplus of £10.4 million projected at the beginning of the year. It should be noted that NES carried forward funding of £10.4 million from 2005/06 resulting in an in-year surplus of £2.72 million over the annual allocation.

PFI/PPP contracts

3.08 NES does not have any PFI/PPP arrangements in place at present, and does not at this stage anticipate their use in future periods. As a result, it has not been necessary for us to provide any specific views on the accounting treatment for such projects.

4. Financial Performance 2006/07

- 4.01 NES is responsible for conducting its affairs and for putting in place proper arrangements to ensure that its financial position is soundly based.
- 4.02 NES reported a surplus of £13.12 million in 2006/07 all of which is to be carried forward to 2007/08. As this is greater than the 1% of RRL allowed for carry forward, NES required Scottish Executive approval for this action.

Financial Performance in the Year

- 4.03 It is emphasised that we do not express a specific audit opinion on the figures on the following pages these have been extracted in agreement with management from various reports, supporting papers and detailed discussions with management.
- 4.04 The table which follows sets out NES' financial position for 2006/07, split between recurring and non-recurring income and expenditure.

	£m	£m
Recurring income	342.4	
Recurring expenditure	(338.2)	
Underlying recurring surplus/(deficit)		4.2
Non-recurring income	14.0	
Non-recurring expenditure	<u>(8.5)</u>	
Balance of non-recurring		<u>5.5</u>
Difference		9.7
Other income sources	2.6	
Non-recurring SEHD income/year-end support	-	
Corporate savings programme	0.8	
Total other income		<u>3.4</u>
Financial surplus/(deficit)		13.1

4.05 The underspend of £13.12 million compares against a budgeted underspend of £10.4 million as follows:

	Original Forecast Underspend	
	£000	£000
Dental Action Plan	6,000	8,050
Internationally Qualified Nurses	-	1,200
Audiology	800	860
Agreed Projects	-	805
General Underspend	3,600	2,205
	10,400	13,120

Dental Action Plan (DAP)

- 4.06 In 2005/06 and 2006/07, NES received significant levels of ring fenced funding in relation to the Dental Action Plan. This funding is intended to support a range of educational initiatives aimed at improving access to dental services. A significant element of this relates to the establishment of dental outreach, and teach and treat centres. These all involve new capital facilities, which are being developed by NHS Boards, with NES providing revenue support for teaching staff. Some slippage in these developments has meant that expenditure of full amounts of allocated revenue has not been possible. £3.6 million of funding for this project was carried forward from 2005/06 with the total under-spend amounting to £8.05 million at the current year end.
- 4.07 The Director of Finance and the Chief Executive have held discussions with the Scottish Executive Health Department to establish the most appropriate way to deal with the ring fenced Dental Action Plan monies. It has been agreed that the full amount can be carried forward to 2007/08 and that £5 million of this can be transferred to help support Modernising Medical Careers ("MMC").
- 4.08 It is anticipated that there will be an underspend of £9.4 million in the Dental Action Plan in 2007/08. However, by 2009/10 it is predicted that NES will be able to fully commit the annually allocated budget in support of Dental Action Plan targets.

Internationally Qualified Nurses

4.09 The Scottish Executive launched a 3 year project during 2006/07 in relation to the employment of internationally qualified nurses. A late allocation of £1.2 million was made in 2006/07 to cover the duration of the 3 year project. The SEHD has allowed the full £1.2 million to be carried forward to 2007/08 in relation to this project. An under-spend is expected again in 2007/08 in this area, reflecting the fact that the project is due to continue into 2008/09.

Audiology

- 4.10 The amounts received in relation to audiology are specifically ring fenced to pay bursaries for Clinical Placement years. The Executive pays a fixed amount each year to cover an equal portion of the total cost. Payments by NES are made in the third year of the student's studies and therefore the first payments are not due until 2007/08. As a result of this mis-match in payment timing, an under-spend is expected in the early years of the project.
- 4.11 It had been projected initially that there would be an £800,000 under-spend in relation to audiology in 2006/07, £435,000 of which had been carried forward from 2005/06. By the year end the actual under-spend had increased slightly to £858,000.
- 4.12 As noted above, this under-spend was predicted in the budgets and it is expected that further under-spends will arise in this area until the payment patterns reverse.

Additional agreed specific projects

4.13 £805,000 of the year end under-spend is to be carried forward in relation to additional agreed specific projects. This includes other projects such as Consultants 600 project, pharmacy and non medical endoscopers and assistant radiographers.

General Carry Forward

4.14 The general under-spend, which is to be carried forward to 2007/08, of £2.205 million represents 0.6% of the RRL in 2006/07. A carry forward of 1% is generally allowable by the SEHD and NES tries to work within a budget which includes an element of carry forward.

Overspends

- 4.15 Notwithstanding the significant under-spend in the year a number of areas did overspend in the year as follows:
 - GP Medical Central overspent by £186,000 this was caused by the late decision to pay CPD grants to GP training practices;
 - Psychology was overspent by £748,000 this was caused by the costs associated with Agenda for Change;
 - E-Library overspent by £250,000 this is mainly due to the use of temporary staff and consultants in this department;
 - HR overspent by £200,000 this was caused by the level of advertising performed in the year;
 - Relocation and advance base showed an overspend of £286,000 – this was primarily due to the write off of costs of furniture and fittings at the new base.

Action Point 1

5. Forecast Financial Position for 2007/08

Financial Plans for Future Periods

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

The Board's Forecast Position for 2007/08	£'m Actual	£'m Actual
Recurring income	366.7	
Recurring expenditure	(361.3)	
Underlying recurring surplus		5.4
Non-recurring income	15.7	
Non-recurring expenditure	<u>(10.3)</u>	
Balance of non-recurring		<u>5.4</u>
Difference		10.8
Other income sources	1.7	
Non-recurring SEHD income/year-end support	1	
Corporate savings programme	1.4	
Total other income		<u>3.1</u>
Surplus for 2007/08		13.9

Confirmed by NHS Board Director of Finance:

5.02 NES is forecasting that it will continue to underspend against its RRL, with the key areas of underspend being:

	£000
Dental Action Plan	9,400
Audiology	400
Internationally Qualified Nurses	600
General Underspend	<u>3,500</u>
	13,900

2007/08 Income

- 5.03 The growth in recurring funding for 2007/08 has been confirmed at 6%. However it is anticipated that the annual increase in recurring funding will decrease to 4% from 2008/09. However, NES has in place a 5 year financial plan which ensures that any risk relating to lower levels of uplift can be managed.
- 5.04 At present, the £15.7 million non-recurring funding identified within the financial plan relates to carried forward amounts of £14.3m plus a further £1.4m in relation to special projects.
- 5.05 Included within non-recurring funding is the £5 million underspend in relation to the Dental Action Plan which has been transferred to support MMC. Aspects of the expenditure which will be covered by this £5 million in 2007/08 will in fact be recurring in nature. Management is aware of the need to identify recurring funding to cover these costs going forward.

Action Point 2

Planned Expenditure

- 5.06 The financial plan incorporates an efficiency saving of 3% of the revenue budget (excluding Training Grades and ACT), being £1.444 million. The equivalent target of £753,000 was achieved in 2006/07.
- 5.07 The savings target for 2007/08 is considered by management to be a tight but achievable target. However, it is important that the progress against this efficiency target is monitored to ensure that it can be met.

Action Point 3

Cost Pressures

5.08 Notwithstanding the healthy surplus projected by NES for 2007/08, management has identified a number of financial risks as follows:

Agenda for Change

5.09 The work completed to date in respect of the Agenda for Change indicates that there will be additional ongoing costs relating to the increments paid to staff. NES staff and those paid by NES, such as trainee clinical psychologists, will assimilate to an Agenda for Change pay scale that may be higher than their current placement and will entitle them to receive increments in coming years.

Modernising Medical Careers (MMC)

- 5.10 The Modernising Medical Careers programme marks a major reform of post graduate medical education. The aim is to deliver a modern training scheme and career structure that will lead to a consultant led NHS providing improved service for patients and improved career progression for junior doctors. NES has the lead role in ensuring the educational implementation of MMC and this responsibility has become a key part of NES core business.
- 5.11 The financial impact of MMC was relatively limited during 2006/07. However, this will change in future years, with some financial pressures already identified in respect of 2007/08. As a result, it has been agreed with SEHD that £5 million of the underspend in respect of the Dental Action Plan carried forward to 2007/08 will be earmarked for MMC. This money will be used as follows:
 - £1.5m (recurring) to fund an additional 50 GP posts;
 - £0.5m available for any required fixed term posts to support service needs during this stage of implementation of MMC;
 - £1.9m £3m to maintain funding for posts for up to 6 months once consultants come out of training.
- 5.12 As highlighted above MMC represents a financial (and operational) risk for NES. The full cost implications are not yet certain and aspects of the costs in 2007/08 are being met from non-recurring carry forward funding. This is clearly not sustainable in the long term. However, management is confident of being able to manage MMC within its anticipated future funding allocation.
- 5.13 A further potential costs pressure arising from MMC may be the need to further develop the supporting infrastructure. Following the difficulties encountered with the Medical Training Application System ("MTAS") at a national level, NES was required to develop, at very short notice, an in-house system to support the recruitment process in Scotland. If this local solution is required to be maintained for the next recruitment round, it is likely that funding will be needed to develop the system on a more sustainable basis.

Relocation

5.14 NES continues to await approval of its Full Business Case to support its relocation to Glasgow. Whilst the change in administration at Scottish Executive level may lead to some uncertainty around the implementation of the policy, NES' accommodation leasing arrangements are such that relocation, whether within or outwith Edinburgh, will be required. The funding

for the cost of such a move has yet to be agreed.

5.15 These pressures will require to be monitored by management to ensure that the ongoing financial sustainability of NES is not undermined.

Action Point 4

The Audit Process and Accounting Issues

Audit Process

6.01 The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided and internal review process undertaken by management were of a good standard. Overall, we believe an efficient audit process was achieved and an effective working relationship exists with your staff.

Preparation of Financial Statements

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

Financial Statement Approval

6.04 The Financial Statements were considered by the Audit Committee on 19 June 2007, and recommended to the Board on 28 June 2007 where they were approved and adopted.

Accounting and Other Issues

6.05 We would like to draw to your attention the following matters in respect of the financial statements:

Agenda for Change

- 6.06 NES currently has an accrual for £2.2 million included within its accounts in relation to the Agenda for Change. This accrual relates primarily to the costs associated with trainee clinical psychologists and associated tutors who have not yet been assimilated.
- 6.07 Management has judged that there is no requirement to include a provision in the accounts in respect of any appeals against the outcome of Agenda for Change. This is on the basis that the majority of appeals faced by NES relate to staff on protected salaries meaning that even if successful, the financial impact will be minimal. We concur with management's view.

Relocation Provision

6.08 The financial statements include a provision of £548,000 in respect of costs associated with the relocation of NES from its current premises. The costs covered by this provision relate to the dilapidation expenditure which will be required to restore the premises to their original condition. Notwithstanding the fact that the Full Business Case has yet to be approved, we concur with management's inclusion of this provision.

Payment Policy

- 6.09 NES seeks to comply with the principles of The Better Payment Practice Code by processing supplier invoices for payment without unnecessary delay and by settling them in a timely manner.
- 6.10 In 2006/07 the average credit taken was 33.27 days, compared to 32.35 days in 2005/06. The invoices paid within 30 days, by value, were just 54.15%, compared to 44.27% in 2005/06. This is a poor record, relative to other NHS bodies.
- 6.11 Management is aware that the current invoice authorisation system is slow and is attempting to introduce an electronic process which should reduce the average payment time.

Action Point 5

Equal pay Claims

6.12 The NHS in Scotland has received a number of claims for backdated pay increases arising from the Equal Pay Directive. At the date of this report, NES had received no such claims and as a result has made no disclosure in its financial statements in this regard.

Misstatements and Significant Audit Adjustments

- 6.13 Misstatements represent audit findings where we do not agree with the amount, classification, presentation or disclosure of items in the financial statements. A misstatement may arise from an error or fraud and other irregularity. An error refers to an unintentional misstatement in financial statements.
- 6.14 In conducting our procedures, we may identify misstatements that require adjustments to the recorded amounts. These audit adjustments are discussed with management who, in consultation with us, determine if an adjustment should be recorded. Our expectation is that all non trivial differences are adjusted.
- 6.15 As a result of our work to date, we identified only one adjustment to the figures within the accounts, which has been adjusted by management.
- 6.16 A small number of disclosure adjustments were noted during the course of our audit. These have all been processed by management.

7. Systems of Internal Control

Statement on Internal Control

- 7.01 The Code of Audit Practice requires us to review and report on the Statement of Internal Control given under the relevant code before its publication.
- 7.02 NES has used the correct format for its statement as prescribed in the Manual of Accounts and has outlined the processes designed to identify and evaluate risks. In addition, key elements of NES's control framework have been highlighted including:
 - A clearly articulated strategic plan, supported by a detailed corporate plan and operational plans at the level of individual directorates;
 - Regular reports to the Board and the Finance and Performance Management Committee on performance against key strategic targets;
 - Regular reports, including the minutes, to the Board from the Chairs of the Staff Governance, Educational Governance, Finance and Performance Management, Educational Research Governance, and Audit Committees; and
 - The existence of a risk management strategy which has been in place since January 2004 and which was reviewed and substantially updated in September 2006.
- 7.03 Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

Follow Up Report on Previous Control Matters Raised for Action

- 7.04 We followed up NES' progress in implementing the recommendations made by the previous external auditors. Our Follow Up Report was considered at the Audit Committee in April 2007.
- 7.05 Of the 7 recommendations made in reports issued in 2005/06 progress was as follows:

Action Implemented	2
Action In Progress	5
	7

Financial Systems and our 2006/07 Internal Controls Report

7.06 Our Internal Controls Report was presented to Audit Committee in June 2007. It contained 6 weaknesses, none of which were considered to be high risk.

7.07 NES has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion.

Internal Audit's Report on NES' Internal Controls

- 7.08 The extract of the Internal Auditor's opinion for 2006/07 is reproduced below:
- 7.09 "Significant assurance can be given that there is a generally sound system of internal control, designed to meet the organisation's objectives, and that controls are generally being applied consistently. However, some weakness in the design and/or inconsistent application of controls put the achievement of particular objectives at risk."

8. Governance Arrangements

Statement of Corporate Governance

- 8.01 Through good governance, NHS boards are able to improve services they deliver and the working lives of staff they employ. Governance means setting the strategic direction within the parameters laid down by the Scottish Executive Health Department's policies, providing leadership, setting the tone for the whole organisation, overseeing the control of the organisation's work and reporting activities and progress to stakeholders. NHS board members are, therefore, collectively responsible for the success of their organisation.
- 8.02 Governance within NES can be considered under four main headings:

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

- 8.03 NES is continuing to develop its governance arrangements, with recent changes in the way its educational governance responsibilities are discharged. NES discharges its governance responsibilities through the following committees:
 - Audit;
 - Staff Governance;
 - Educational Governance;
 - Education Research Governance; and

Finance and Performance Management.

Financial and Performance Governance

- 8.04 NES has established a standing committee of the Board specifically to consider Finance and Performance Management, albeit a report on Finance and Performance Management is presented to each Board meeting. The Finance and Performance Management Committee meets quarterly and submits a report to the Board after each of its meetings.
- 8.05 Financial and performance management at NES is underpinned by a performance management system which was developed by NES during the year. This system, a dashboard reporting tool, enables NES to interrogate its performance against its overall strategic objectives, the Local Delivery Plan and its HEAT targets.

Educational Governance

- 8.06 As a relatively young organisation, a key issue for NES is to ensure that a corporate approach to governance is adopted by all parts of the organisation. This is particularly applicable to Educational governance which is delivered by a number of different parts of the organisation.
- 8.07 To address this, NES has had in place an Educational Quality
 Assurance Committee since its inception. However, in 2006/07 its
 remit was significantly strengthened to form the Educational
 Governance Committee which now takes an active oversight of all
 NES educational activity. The Educational Governance Committee
 reports directly to the Board and was established as part of the
 wider Educational Governance Framework.
- 8.08 The committee provides assurance to the NES Board on all aspects of the quality assurance of its educational provision.
- 8.09 The Educational Governance Framework was established in 2006. The Framework exists to pull together all of the educational processes in place throughout the organisation and review them for quality.

Risk Management

- 8.10 Risk management is often defined as a systematic process for identifying, assessing, controlling, monitoring, reviewing and auditing risk. Effective risk management is of critical importance to the health service as adverse consequences of risk could place limitations on the quality of health care delivery, and put a strain on staff and financial resources.
- 8.11 All Health Boards are required to implement a robust and effective framework for the management and understanding of risk. The framework should be developed by building on existing good practice and should be used to facilitate planning and decision making processes.

- 8.12 NES continues to develop its approach to risk management with both corporate and local risk registers now in place.
- 8.13 The Audit Committee oversees the risk management process with specific risks being communicated upwards to the Board. For example during 2006/07 as a result of its increasing prominence a decision was taken to have Modernising Medical Careers as a standing agenda items at all Board meetings.

Staff Governance

- 8.14 The NHS Reform (Scotland) Act amended the National Health Service (Scotland) Act 1978, making it a legal requirement for Health Boards to have in place arrangements for good governance of staff. It is the duty of every Health Body to put and keep in place arrangements for the purposes of:
 - improving the management of the officers employed by it;
 - monitoring such management; and
 - workforce planning.
- 8.15 The Staff Governance Committee has an important role in ensuring consistency of policy and equality of treatment of staff across the organisation and continues to meet on a regular basis to address and respond to relevant issues and to ensure that progress against Staff Governance Action Plan continues.
- 8.16 It is governed by a formal remit which details its roles and responsibilities.

Prevention and Detection of Fraud and Irregularities

Responsibility with respect to Fraudulent and/or Illegal acts

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

Fraud and Corruption Reviews

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

National Fraud Initiative

9.07 In 2006/07 NES took part in the National Fraud Initiative (NFI) in Scotland. The Health Department and NHS Counter Fraud Services has strongly supported the involvement of health bodies in the exercise, which is undertaken as part of the audits of the participating bodies.

- 9.08 NFI brings together data from health bodies, councils, police and fire and rescue boards, and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. Health bodies provided payroll data for the exercise.
- 9.09 The NFI has generated significant savings for Scottish public bodies (£2 million to 2005) but, if fraud or overpayments are not identified, assurances may be taken about internal arrangements for preventing and detecting fraud.
- 9.10 The NFI 2006/07 results (data matches) were made available to health bodies on 29 January 2007 via a new secure web-based application. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application.
- 9.11 Work has been undertaken by NES to review each of matches reported, with no instances of fraud identified. The primary cause of matches highlighted was due to dual employment, with a number of staff working for other organisations. In addition, some issues were raised regarding the visa status of some employees. However, it appears that this is due to out of date data held by the Home Office, rather than issues at NES.

Fraud Guidance

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

Fraud Submission

9.13 A return is made to Audit Scotland of all the reported frauds in the year. NHS Education for Scotland had a "nil" return for 2006/07

10. Other Business Matters

Priorities and Risks Framework

- 10.01 Audit Scotland publishes an annual Priorities and Risks Framework (PRF), a planning tool for auditors that sets out key high level risks facing Health Boards in Scotland. For 2006/07, the identified risk areas were categorised into the following areas:
 - Service sustainability
 - Financial management
 - Governance
 - Performance management
 - People management
 - Partnership working
 - Information management
- During the course of our audit, we considered each of the key risk areas highlighted within the PRF, the impact these areas have on NES and planned our audit work accordingly. Financial management performance management and governance have been considered previously in separate sections (see sections 3 and 7). The significant points noted from the remaining sections have been detailed below.

Service Sustainability

- 10.03 NES has a shared vision of where the organisation will be in the next 3-5 years. This vision is documented in a Corporate and Management plan which is approved by the Board on an annual basis.
- 10.04 In addition NES has developed a five year investment strategy which details the organisation's planned investment over the longer term.
- 10.05 There are however key risks which could hinder the extent to which NES achieves its corporate objectives over the short to medium term. These have been detailed below.
- 10.06 In the short to medium term various members of the senior management team are likely to leave the organisation. This will be in part due to retirements and in part due to the proposed relocation of services to Glasgow. Whilst the Board recognises the potential risks associated with the loss of key personnel the situation also presents an opportunity for the organisation to restructure its governance framework as a reflection of the organisation's evolving working practices.

10.07 The implementation of MMC remains a significant risk to the organisation, both financially and operationally. This is particularly so given the failure of the national MTAS system and the need at short notice to develop local systems.

Action Point 6

People Management

- 10.08 Agenda for Change is a major change programme in the NHS, designed to modernise pay structures, assist service delivery of patient care, aid recruitment and retention and allow for personal development of staff. The new pay structure consists of nine pay bands and several pay points within each pay band. Individual posts have been mapped to a pay band by either matching the job to the national profile or through a local job evaluation.
- 10.09 The original national timetable for two key elements of Agenda for Change was for all staff to be transferred to a new pay grade ("assimilated") and have a validated Knowledge and Skills outline as part of the Knowledge and Skills Framework by October 2006. NES was one of the few boards to meet the timetable.
- 10.10 By the end of April 2007, all of NES's own employees have been transferred onto the new scales. However, some other groups who are paid by NES, such as trainee clinical psychologists and associated tutors, have yet to be assimilated.
- 10.11 A further part of the process involves processing requests for a review from staff not satisfied with their placement on the new salary structure. Whilst NES has received some appeals regarding Agenda for Change, this is not considered by management to be a significant issue, with minimal financial impact.
- 10.12 In addition to the uncertainty surrounding Agenda for Change the proposed relocation has also created uncertainty for staff. Given the change in the political administration, it is likely that this uncertainty will continue.
- 10.13 In response to the proposed relocation the Human Resources team have undertaken various exercises to ensure the staff are kept up to date with the latest developments. An example of such an initiative was the organisation of a 'Do You Know Your Rights' seminar which was well attended and included representation from the Central Legal Office.

Partnership Working

- 10.14 Given the strategic objectives of NES, it is required to work in partnership with a wide range of organisations, both formally and informally. This is recognised at the Board where the role of NES and its partners, such as Scottish Funding Council, are regularly discussed.
- 10.15 During 2006/07 the Board updated its external and internal communication strategies. Both of these strategies have been updated as the result of the findings of an external attitude and awareness study and an internal communications audit. The emphasis on partnership working has been incorporated into

- 2006/07 Corporate Plan with the organisation reiterating its desire to work in partnership with a wide variety of NHS and wider public sector organisations.
- 10.16 NES continues to recognise the continuing need to communicate its complex role to its numerous stakeholders and that publications such as 'NES The Basics' and 'Communiqué' are facilitating this process.
- 10.17 The NES Board contains Non Executive representatives from a wide variety of backgrounds. This allows the Board to incorporate the views/ experiences of a significant number of its key partner organisations into its governance process.
- 10.18 Moving forward the key risk to partnership working will again be the implementation of Modernising Medical Careers. The extent to which the implementation is successful will depend on NES working closely with all of Scotland's territorial health boards as well as with the Scottish Executive Health Department. To facilitate this process NES continues to attend regional planning meetings and also meets regularly with individual boards on a one to one basis.

Information Management

- 10.19 An integrated Information and IT function was created when the Board came into being in 2002.
- 10.20 As at June 2007 an Information Strategy is in place for the years 2003-08. A document has also been produced for submission to external consultants to assist in a refresh of this strategy to accommodate changing national policies. It is envisaged that this will be in place by October 2007.
- 10.21 To date IT information is not reported to the Board on a routine basis. However, significant developments and business cases are reported to the Business Group, an executive committee.
- 10.22 There is a formalised disaster recovery and business continuity plan. This was last reviewed on the 20th of December 2006. Backups are taken of all servers and tapes are stored offsite.
- 10.23 Developing the work of NES and delivering national IT projects present significant challenges to NES, especially with the possibility of relocation.

Relocation

10.24 The Scottish Executive announced in 2002 that several government organisations, including NHS Boards, were to be relocated out of Edinburgh to create jobs in areas of deprivation. The decision to move NES to the east end of Glasgow was approved by ministers in July 2005, with the move planned to take place around May 2007.

- 10.25 A temporary office has been established in Glasgow and plans are underway to vacate the current premises. However, with the change in administration at the Scottish Executive there remains a great deal of uncertainty over the relocation project.
- 10.26 Despite this uncertainty, it will be necessary to move out of the current premises. The lease on Rose St expires in 2008, with the lease for Queen St expiring in 2010/11.
- 10.27 It is likely that the potential relocation will start to have an operational impact, both in terms of staff morale and NES' ability to recruit. Management is aware of these issues and the risks they pose to the organisation.

Action Point 7

Appendix 1: Action Plan

Ref	Recommendation	Risk Category	Management Response	Responsible Officer	Date of Implementation
4.15	Management should work with the budget holders of those areas which overspent during 2006/07 to ensure a similar situation does not arise in 2007/08.	Low	Agreed.	Head of Management Accounts	Ongoing
5.05	Management should review the funding of MMC to reduce the reliance on non-recurring funding.	Medium	Agreed.	Director of Finance	31 March 2008
5.07	Management should monitor the delivery of the agreed savings target and take recovery action as necessary.	Low	Agreed.	Head of Management Accounts	Ongoing
5.15	Management should continue to monitor these cost pressures to ensure the ongoing financial sustainability of the organisation.	Low	Agreed.	Director of Finance	Ongoing
6.11	Management should carry out a review of its creditor payment processes to identify ways in which its payment performance can be improved.	Low	Agreed.	Assistant Director of Finance	30 September 2007
10.07	Management should agree its role in the continued implementation of MMC with SEHD, particularly with regard to the development of recruitment systems.	High	Agreed.	Director of Finance/ Director of Medicine/Chief Executive	30 September 2007
10.27	Management should continue to liaise with the Scottish Executive to finalise the relocation project and to agree the funding of associated costs.	Medium	Agreed.	Director of Planning and Information/Director of Finance	Ongoing

27 PricewaterhouseCoopers LLP

Appendix 2: Responsibilities of External Audit and NHS Education for Scotland and its Management

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

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

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

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

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

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

- The legality of transactions that might have significant financial consequences;
- The financial standing of the audited body;

- Systems of internal financial control; and
- Standards of financial conduct and the prevention and detection of fraud and corruption.

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

For more details on any of the issues raised in this document reference should be made to those detailed reports issued by us to NHS Education for Scotland during the year as listed at **Appendix 4**.

Materiality

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

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

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

Guidelines for this organisation suggest that preliminary materiality be set at approximately 0.5% of turnover. However, materiality is not simply a quantitative figure. Qualitative aspects also need to be considered in assessing whether something would be significant to a user of the financial statements.

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

Management's Judgments and Accounting Estimates

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

Appendix 3: Audit Opinion

Independent auditor's report to the members of NHS Education for Scotland, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of NHS Education for Scotland for the year ended 31 March 2007 under the National Health Service (Scotland) Act 1978. These comprise the Operating Cost Statement, the Balance Sheet, the Cash Flow Statement and Statement of Total Recognised Gains and Losses and the related notes, but excluding the Directors' Report. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Board Members, Chief Executive and auditor

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

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

We report our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report 2006/07 to be audited have been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers. We also report whether in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. We also report if, in our opinion, the Directors' Report is not consistent with the financial statements, if the body has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

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

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements; the financial statements being the only part of the Annual Report which we have audited. This other information comprises only the Directors' Report and Operating and Financial Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Auditor General for Scotland. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income included in the financial statements and the part of the Remuneration Report 2006/07 to be audited. It also includes an assessment of the significant estimates and judgements made by the board and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are appropriate to the body's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report 2006/07 to be audited are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report 2006/07 to be audited.

Opinion

Financial statements

In our opinion

the financial statements give a true and fair view, in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers, of the state of affairs of NES as at 31 March 2007 and of its surplus, total recognised gains and losses and cash flows for the year then ended; and the financial statements and the part of the Remuneration Report 2006/07 to be audited have been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers.

Regularity

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

PricewaterhouseCoopers LLP Glasgow

28 June 2007

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

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

Planning visits

Outline Audit Approach

Interim Visit

Follow Up of 2005/06 Audit Recommendations Internal Controls and Governance Report 2006/07

Final Accounts Visit

Audit Opinion

Annual Report to Board Members

Freedom of Information (Scotland) Act 2002

This report is intended solely for the information of the Members of the Board of NHS Education for Scotland and the Auditor General for Scotland. In the event that, pursuant to a request which these parties receive under the Freedom of Information (Scotland) Act 2002, it will notify PwC promptly and consult with PwC prior to disclosing such External Audit Report. NHS Education for Scotland agrees to pay due regard to any representations which PwC may make in connection with such disclosure and NHS Education for Scotland shall apply any relevant exemptions which may exist under the Act to such External Audit Report. If, following consultation with PwC, NHS Education for Scotland discloses this External Audit Report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed. PricewaterhouseCoopers LLP does not accept any responsibility to any other party to whom this report may be shown or into whose hands it may come.

© 2007 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to the PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

This report is protected under the copyright laws of the United Kingdom and other countries. It contains information that is proprietary and confidential to PricewaterhouseCoopers LLP, and shall not be disclosed outside the recipient's company or duplicated, used or disclosed in whole or in part by the recipient for any purpose other than to evaluate this proposal. Any other use or disclosure in whole or in part of this information without the express written permission of PricewaterhouseCoopers LLP is prohibited.