

NHS Education for Scotland Annual Report to Board Members and the Auditor General for Scotland 2009/10



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The principal objective of our audit procedures is to enable us to express our opinion, in line with the requirements of the Audit Scotland Code of Audit Practice, on the financial statements as a whole. Our audit opinion does not guarantee that the financial statements are free from misstatement. Our audit responsibilities, and their limitations are explained in our letter of appointment.

Any oral comments made in discussions with you relating to this report are not intended to have any greater significance than explanations of matters contained in the report. Any oral comments that we make do not constitute oral advice unless we confirm any such advice formally in writing.

The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks at NES or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

1. Executive Commentary

Introduction – Section 2

Our overall responsibility as external auditor of NHS Education for Scotland (NES) is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice (“the Code”), revised and published in March 2007.

We have a dual reporting responsibility for the audit: to the Board Members of NES and to the Auditor General for Scotland.

Financial Statement and Audit Opinions – Section 3

The financial statements of NES for the year ended 31 March 2010 have been prepared to comply with accounting requirements contained in the NHS Board Accounts Manual for Directors’ Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

We are pleased to report that our **true and fair opinion** and **regularity opinion** on the financial statements for the year ended 31 March 2010 are **unqualified**.

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 relevant parts of the **Remuneration Report is unqualified**. It should be noted that our audit opinion does not extend to other parts of the Annual Report.

Basis of Preparation – International Financial Reporting Standards

Government bodies, including NHS Boards, have been required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. This included a restatement of 2008/09 comparatives. The objective is to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting.

Accounting Issues

A number of accounting issues were discussed with management during the audit. The most significant of these are set out below:

- Assessment of going concern – net liability position;
- Bank reconciliations; and
- Disclosure of future operating lease expenditure

Financial Performance 2009/10 – Section 4

NES is required to meet three targets each year as set by the Scottish Government Health Directorate (SGHD). All three of these were achieved in the year. NES also reported efficiency savings in the year above the 2% Scottish Government target.

Governance and Performance 2009/10 – Section 5

We have reviewed NES's overall governance arrangements including a review of Board and key Committee structures and minutes, financial reporting to the Board, and risk management. Appropriate arrangements and reporting were noted. We have also considered key areas of risk to NES including partnership working; service sustainability; performance management; and people management. We have reviewed NES's overall systems of internal control including a review of IT general controls (ITGC); the National Fraud Initiative; and internal audit arrangements. Appropriate arrangements and reporting were noted.

Managing in Uncertain Times – Section 6

The UK economy went into recession in mid-2008 for the first time since 1991. Although the economy is showing apparent signs of recovery from the recession, significant financial pressures remain and the future economic position is uncertain and difficult to predict. As a result of the current economic position, Audit Scotland has issued a number of reports on the matter. Key reporting themes from two of these reports: 'Scotland's Public Sector Finances' and 'Improving Public Sector Efficiencies' are included in the body of this annual report. Based on our experiences from other clients and sectors we concur with the matters raised by Audit Scotland and others.

To meet the significant challenges ahead, we recommend that NES looks at six key areas which our experience in other sectors has shown may be relevant to addressing the challenges ahead: "Honesty and awareness of the size of the challenge"; "Strong leadership"; "Need to engage with the whole organisation and external stakeholders"; "Realistic and detailed plans to resolve the situation"; "Rigorous implementation (programme management arrangements)"; and "Financial control and discipline".

2. Introduction

Purpose of this report

The Annual Audit Report which follows is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically this will direct your attention to matters of significance which have arisen out of the 2009/10 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

Scope, nature and extent of our audit

Our overall responsibility as external auditor of NHS Education for Scotland (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. 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. It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving the “appointed auditor”, the Auditor General for Scotland and other auditors such as Audit Scotland’s Health Performance and Public Reporting Group. Our audit has been planned and conducted to take account of these wider perspectives. Under the requirements of International Standard on Auditing (UK and Ireland) (‘ISA’) 260: “*Communication of audit matters to those charged with governance*”, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This Annual Audit Report to Members, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

Acknowledgment

We would like to formally extend our thanks to all NES managers and staff for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP
Glasgow, 16 June 2010

3. Financial Statement and Audit Opinion

Audit opinion

Our audit opinion concerns both the true and fair statement of NES's financial results for the year ended 31 March 2010 and the regularity of its income and expenditure for the year.

We are pleased to report that our opinion on the true and fair view on the financial statements and on the regularity of income and expenditure is **unqualified**.

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.

Audit Process

The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided by management was of a high standard. Overall an efficient audit process was achieved through an effective working relationship with your staff.

Basis of Preparation

The financial statements were prepared in accordance with the accounting requirements contained in the NHS Board Accounts Manual for Directors' Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

Government bodies, including NHS Boards, have been required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. This included a restatement of 2008/09 comparatives. The objective is to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting.

In order to prepare financial statements which are IFRS compliant, NES has been required to change the format of its financial statements and include a considerable number of additional disclosures. Significant work has been undertaken (in consultation with the PricewaterhouseCoopers' technical support team) to achieve this objective.

Over the last 18 months this has required a significant time commitment by the Deputy Director of Finance and her team and it is to their credit that this first full audit under IFRS has been completed smoothly.

Approval

The Financial Statements were submitted to NES's Audit Committee on 16 June 2010 and are to be approved and adopted at the Board meeting on 24 June 2010.

Unadjusted misstatements

Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those which we deem to be of a trivial nature. As a result of our work, we proposed a number of audit adjustments and all of these have been processed by management in the finalised version of the 2009/10 financial statements. We, therefore, have no unadjusted 2009/10 misstatements to report.

Accounting Issues

Going concern

NES is currently disclosing total net liabilities of £14.379 million on its balance sheet as at 31 March 2010 (2009: £18.283 million) meaning that it is technically insolvent. Under the current accounting arrangements as set out in the Financial Reporting Manual (FReM) NES must show liabilities on its balance sheet without drawing down the equivalent cash to fund them. However, as these liabilities fall due, the cash will be requested from the SGHD to meet the payments.

We are satisfied that the accounts have been correctly prepared on a going concern basis.

Bank reconciliations

Bank reconciliations are the key financial control in any organisation. This key reconciliation provides the safeguard that risks relating to cash payments such as inappropriate payments, banking errors, incorrect postings and fraud are mitigated.

In our Interim Management Letter, reported to the Audit Committee in April 2010, we reported that NES had been unable to fully reconcile its records to bank statements since October 2009. This was impacted by a combination of factors - a decision taken by NES to make use of e-Financials "auto bank reconciliation" on the premise that this would save staff time and automate the bank reconciliation process and the continuing difficulty experienced in the recruitment of a Financial Services Manager. The functionality of this system has had the opposite effect and not met NES's needs. Considerable staff time has been required to fully reconcile the year end bank balance. Indeed, by the time the reconciliation had been completed, management, and ourselves required to perform additional testing at year end to gain comfort that the cash and bank balance was not materially misstated. ***NES should consider the suitability of the current bank reconciliation arrangements and, until such time that functionality is improved, put in place appropriate alternative processes that will facilitate the timely completion of month end bank reconciliations.***

Action 1

Disclosure of future operating lease expenditure

NES is required to disclose future operating lease expenditure, to the point at which NES is committed to making payments, on the time basis noted below.

- Less than 1 year;
- 5 years; and
- Greater than 5 years

During our review we identified two leases that included break points allowing NES the opportunity to withdraw from the contract. NES has updated this disclosure to reflect the break point in these two leases.

4. 2009/10 Performance

Financial Results 2009/10

2009/10 Outturn	£'000	£'000
Recurring income	408,300	
Recurring expenditure (before savings)	(408,300)	
Recurring efficiency savings	1,600	
Recurring underspend	<u>1,200</u>	
Underlying recurring surplus / (deficit)		2,800
Non-recurring income	10,200	
Non-recurring expenditure (before savings)	(10,200)	
Non-recurring efficiency savings	<u>0</u>	
Non-recurring underspend	<u>4,243</u>	
Non-recurring surplus/(deficit)		4,243
Financial surplus/(deficit) for the year		7,043
Underlying recurring surplus / deficit as a percentage of recurring income		0.69%

Figures confirmed by Audrey McColl, Deputy Director of Finance, 4 June 2010

At the start of 2009/10, NES brought forward a surplus of £9.3 million from the previous financial year. In March 2009, NES approved a breakeven budget for 2009/10 which anticipated that the £9.3 million surplus would be retained at the end of the financial period 2009/10.

At the request of the Scottish Government and the subsequent decision of the NES Board to reduce it planned under spend for the year, NES returned £5.6 million of revenue resource to the Scottish Government during the year. At December 2009 it was forecasting a surplus at year end of £7.3 million.

The table to left provides an analysis of NES's 2009/10 final outturn position of £7.1 million. This under spend is broken down as follows:

- General - £2.2 million
- Dental Action Plan - £2.6 million;
- Audiology - £1.2 million;
- Healthcare Scientist - £0.8 million; and
- NMAHP project - £0.2 million.

Budget Variations

A number of over and under spends have contributed to the return of monies to the SGHD during the year and the achievement of a £7.1 million surplus at year end. A number of these have been summarised below:

Regional Medical

The cumulative Regional Medical under spend for the four regions is approximately £1.7 million. This included a £1.1 million under spend for training grades that was the result of the budget being increased by 2.2% to allow for salary uplifts and provide flexibility for double running and LTFT supernumerary posts. While the salary increase was 1.5%, NES did not experience significant double running costs as there was a significant level of recruitment however, if the budgets had simply been increased by the amount of the pay award (1.5%), NES would have slightly overspent on training grades, indicating that it was prudent to provide for some double running costs.

Dental

The under spend position of £2.8 million on the dental budget includes £2.6 million of Dental Action Plan funding which had been agreed as a specific carry forward into 2010-11.

Audiology

NES received funding from the SGHD in advance of the Audiology course being put in place at Queen Margaret University. NES has agreed specific carry forward of £1.2 million which will cover the run out of the Audiology programme in 2010/11 and 2011/12.

Healthcare Scientists (HCS)

The underspend on the HCS budget of £1.1 million results from NES receiving a significant allocation for this work in 2009/10 which it has been required to manage over a 3 year programme. The underspend is £0.2 million more than the agreed carry forward, this is primarily due to a variance arising from the over estimation of running costs in the NHS Tayside SLA.

Educational Development

The final overspend on this directorate is £0.4 million. The primary reason for this overspend is the integration of the new Leadership and management function which NES assumed responsibility for during 2009/10. NES accepted a reduced allocation in 2009/10 but activity levels have been greater than originally estimated

Performance against Key Financial Targets

NES is required to meet three targets each year as set by the Scottish Government Health Directorate (SGHD). NES has achieved all three of its financial targets in the year, as follows:

	Limit set by SGHD £'m	Actual Outturn £'m	Variance (over)/under £'m
Revenue Resource Limit	418.438	411.395	7.043
Capital Resource Limit	1.600	1.539	0.061
Cash Requirement	416.000	415.975	0.025

Creditors – Creditors Payment Days

Government guidance issued in 2008/09 as a result of the economic downturn, states that public sector suppliers should be paid within 10 days.

During 2009/10 improvements in management information have enabled the calculation of supplier payments to be refined. This is now based on the number of days which pass between the invoice being received by NES and the invoice being paid.

In previous years this was based on the number of days which passed between the invoice date and the invoice being paid, therefore performance data for the two years is not comparable. This has been fully disclosed within the Directors Report.

The Financial Statements at 31 March 2010 report a creditor payment day performance of 15 days (2008/09: 41 days).

Performance Monitoring

Key Performance Indicators

NES has a Local Delivery Plan agreed with SGHD. This contains a number of targets structured under four key Ministerial Objectives which are common across NHS Scotland.

- Health Improvement for the people of Scotland – improving life expectancy and healthy life expectancy.
- Efficiency and Governance Improvements – continually improve the efficiency and effectiveness of the NHS.
- Access to Services – recognising patients need for quicker and easier use of NHS services.
- Treatment Appropriate to Individuals – ensure patients receive high quality services that meet their needs.

In addition NES has a number of strategic and operational performance measures.

The NES performance management system is based on a dashboard reporting tool which allows performance information to be captured and monitored against key performance measures at every level of the organisation. The Finance & Performance Management Committee reviews full performance reports generated by the dashboard system on a quarterly basis. These reports use a “traffic lights” system to highlight any areas where action is required.

During our review of the Performance Management Reports we noted no significantly poor performing areas.

Sickness Absence

The Board has a pro-active policy on the management of sickness absence and the absence rate for 2009/10 was 2.94% (2008/09 3.2%). It has been reported at the Finance & Performance Management Committee that a large proportion of absences were accounted for by a small number of long term sick absences. Work was currently underway in HR to extrapolate out long term sickness absence so NES can obtain a more accurate picture of short-term absence figures.

Best Value

Best Value audits are being carried out across the public sector to help protect taxpayers interests by examining the use of resources and to report on the delivery of outcomes for people who use services. The Best Value audits are being carried out in a cycle focusing on distinct areas each year. In 2008/09 the Use of Resources Best Value audit focused on Information Management. In 2009/10 Audit Scotland issued 18 toolkits with instructions that one was to be performed and validated by the auditors of each NHS Board.

In order to add value and address the key risk areas of priority to NES management, we performed one BV toolkit review in 2009/10: People Management. A summary of NES's assessment against the key areas of the toolkit is summarised below:

People Management Toolkit Module	Evaluation
Effective People Management	Better Practices
Workforce, Strategic and Financial planning	Basic Practices
Achievement of Organisational Goals	Better Practices
Engagement and Performance of Staff	Better Practices

The evaluation for each module is classed as: does not meet basic requirements; basic practices; better practices; and advanced practices. The detailed findings will be reported to Audit Committee at its next meeting.

Within the context of NES operating Better Practices for three of the four modules in the toolkit, some areas for development within these "Better Practices" areas were identified.

5. Governance and Control

Overall Governance Arrangements

NES has in place a well established integrated governance framework, with the Board supported by Audit, Staff Governance, Educational Governance, Remuneration, Education Research Governance, Patient Focus Public Involvement and the Finance & Performance Management Committees. Further support is provided by the Partnership Forum and the Business Group. The Audit Committee receives an annual report from each of the standing committees as a means to provide assurance that the Committee has discharged its responsibilities effectively throughout the year. The assurance is provided to the Board by the Audit Committee.

NHS QIS presented their findings from their November 2009 Clinical Governance and Risk Management (CGRM) peer review. The results were positive with NES exceeding the performance targets it had set following its previous NHS QIS review. The outcome of the NES review was reported to the Audit Committee in April 2010.

Partnership Working

NES works in partnership with the full range of organisations involved in the preparation and development of the NHS workforce, including the higher education sector and Scotland's colleges; professional organisations such as the Royal Colleges; statutory organisations such as the General Medical Council; the Health Professionals Council and the Nursing and Midwifery Council; and other educational organisations such as the Scottish Funding Council and Skills for Health. NES also works in partnership with other NHS organisations and cross-sectoral links are also in place with organisations outside the NHS, such as the Scottish Social Services Council.

During 2009/10 a Memorandum of Understanding was established with the Scottish Social Services Council (SSSC). NES and SSSC play an important role in supporting the workforce in health and social care. Their collaborative and integrated approach to supporting the workforce has the potential to enhance better patient / client and service outcomes, whilst promoting efficiency.

Service Sustainability

NES has identified that there is a compelling need to change to meet the challenges of the economic downturn as well as the requirement to support delivery of safe and effective person centred services (across health and social care) which are closer to home and involve patients and carers in decision making. At its September 2009 Board meeting, NES outlined its proposed approach to strategic planning over the period 2010 to 2014.

NES anticipates that moving the organisation from one year operational planning to three year strategic planning will be achieved in two stages. Firstly, a one year transitional Corporate Plan (2010-2011) which starts to outline the strategic direction but is based on one year operational targets (as is currently the case). And secondly, this transitional plan will be the precursor to a concise three year strategy covering 2011-2014 in which the overall direction and objectives are set.

Within the new three year strategy a more detailed, structured and focused annual Business Plan will be produced in order to align NES work with the new strategy through setting objectives for the forthcoming year at Directorate level within the staffing establishment and available budget. NES anticipates that following consultation its final strategy will be approved by the Board in November 2010.

People Management – pay modernisation

NHS Boards are to ensure at least 80% of staff covered by Agenda for Change have their annual Knowledge and Skills Framework development reviews completed and recorded on e-KSF by March 2011.

NES successfully achieved 80% of staff covered by Agenda for Change having their annual KSF development reviews completed and recorded on e-KSF one year ahead of the official LDP target of March 2011.

People Management – equal pay

NES is committed to equal pay and has published an Equal Pay Statement on its extranet. The risk of non-compliance with the Equal Pay Act is included in the NES global risk register and measures have been put in place to ensure compliance - including an equal pay audit. NES is required to review and report on its equal pay statement every 3 years with a formal review scheduled for September 2010. NES currently has no equal pay claims pending.

Systems of Internal Control

The results of our work on systems of internal control were communicated to Audit Committee in our Interim Management Letter on 13 April 2010. The report contained 12 recommendations to improve controls, none of which was graded as higher risk. There were also no risks identified that could be considered business critical in nature. NES has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. We will follow up this action plan during our 2010/11 audit process.

Statement on Internal Control

The Code of Audit Practice requires us to review and report on NES's Statement on Internal Control. NES has used the correct format for its Statement and has outlined the processes it has employed to identify and evaluate risks. In addition, key elements of NES's control framework have been highlighted. Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

Follow up of outstanding recommendations

We followed up NES's progress in implementing recommendations made in the prior year. Our Follow Up of Prior Year Recommendations was included in the Interim Management Letter considered at the Audit Committee meeting on 13 April 2010. At the time of reporting, of the 12 agreed actions, progress was as follows:

Status	Interim Management Report 2008/09	Annual Report to Members 2008/09	Total
Action Implemented	9	-	9
Action in Progress	3	-	3
Limited/Little Progress to Date	-	-	-
Not Yet Due	-	-	-
No Longer Applicable	-	-	-
Total	12	-	12

Information Technology General Controls

ISA (UK&I) 315.93 requires auditors to "... obtain an understanding of how the entity has responded to risks arising from IT". IT General Controls (ITGCs) are controls put in place by management to mitigate those risks. ITGCs help ensure the continued proper operation of information systems to maintain the integrity of information and security of data.

A number of issues were raised in the prior year particularly in the area of business continuity planning. Throughout 2009/10 NES has made significant progress in addressing these weaknesses. NES has adopted a location based approach for its planning with revised business continuity plans drafted for each of its seven locations. Key staff at each location have been involved in the development of the plans through a process of interviews and workshops to ensure that business continuity priorities are correctly identified for each location.

NES is currently putting in place a business continuity testing programme although it should be noted that some plans have already been through a cycle of testing as part of being finalised.

As part of our review of ITGCs we have performed testing on a sample basis, enabling us to gain comfort in this area. The output of this work resulted in one weakness being identified, which is unlikely to have had a significant impact on the financial statements.

Internal Audit

The role of internal auditing is determined by management and therefore its objectives differ from those of the external auditors. It is part of our approach to gain an understanding of the internal audit function to determine if it would be effective and efficient to use their work.

During 2009/10 Bentley Jennison continue to act as NES' internal auditors. We have reviewed the work of internal audit and have, where appropriate, placed reliance on their work eliminating duplication of effort.

National Fraud Initiative

The National Fraud Initiative (NFI) brings together data from health bodies, councils, police and fire rescue bodies 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. The 2008/09 NFI project is a 2 year initiative which has just been completed with the report issued by Audit Scotland in May 2010. NES met its mandatory requirements in 2008/09 with regard to the submission of payroll data sets and subsequent investigation of matches. In addition, NFI prescribes that public sector bodies are required to submit additional datasets on a risk-based approach. Management chose not to run the creditors dataset in 2009/10 as the process of implementing the new creditors system was seen to be of higher priority by management.

As reported in our Interim Management Letter (April 2010), no exceptions were noted to our review of this area during the interim audit process. The report issued by Audit Scotland (National Fraud Initiative in Scotland – Making an Impact) made no specific reference to the NHS Education for Scotland.

6. Managing in a Period of Financial Uncertainty

The UK economy went into recession in mid-2008 for the first time since 1991. By summer 2009, UK economic output had fallen for five consecutive quarters. Significant financial pressures remain and the future economic position is uncertain and difficult to predict.

In response to the recession the UK Government almost doubled its level of borrowing to £175 billion in 2009/10 to allow it to increase public spending to support the economy. This level of borrowing means that the UK Government will need to pay higher debt interest payments, which in turn reduces the amount left for spending on the public sector. The recent Westminster General Election has resulted in a change of Government and this has led to a change in the plans for repaying the national debt with the new coalition government planning to halve the debt by 2013/14. In order to achieve this ambitious target, significant reductions in public sector spending will be required. A recent paper by the Scottish Government Chief Economist predicts that public sector spending in Scotland may fall in real terms by 3% every year to 2014/15 and will take a total of 12 to 15 years to get back to 2009/10 levels.

Further details of this challenge may become clearer after the 22 June 2010 UK emergency budget, although the impact this will have on the NHS in Scotland may take some time to become apparent.

In April 2009, the UK Government also announced that Public Sector **capital budgets would fall**.

Taken together, these factors will have **serious consequences** for the Scottish budget. As a result of the current financial position, Audit Scotland has issued a number of reports on the matter. Key reporting themes from two of these reports are highlighted below.

Audit Scotland - Scotland's Public Finances: Preparing for the Future

In November 2009 Audit Scotland published their report: 'Scotland's Public Finances: Preparing for the Future'. This report highlighted the fact that the Scottish Government budget is likely to have peaked in 2009/10 for the foreseeable future. This means that individual public bodies will have **smaller budgets** in future years. It highlighted that in addition, **other public sector income is likely to be less than previously forecast** – in particular, NHS capital funding, which may affect NES's ability to deliver its capital programme.

The report concluded that we are at a real **historical breakpoint** in public finances.

Audit Scotland - Improving Public Sector Efficiencies

Following on from the Scotland's Public Finances report, Audit Scotland published a further report in February 2010: 'Improving public sector efficiency'. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in a 2006 Audit Scotland report about the previous efficiency programme.

The report noted that Scottish public bodies had reported more efficiency savings than the Government's two per cent target. However, there were serious financial challenges ahead – the biggest since devolution – and making the required savings simply through efficiency will become increasingly difficult.

The report recommends that to deal with reduced future funding, public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and to improving collaboration and joint working.

To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. ***We recommend that those responsible for leading efficiency and improvement work at NES should formally assess themselves against each question raised in the combined Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office detailed good practice checklist.***

Action 2

The NES Perspective

Despite entering the downturn from a relatively strong financial position the NHS in Scotland currently faces a period of uncertainty. Impending tightening of public expenditure will impact the sector at a time when the cost base of many NHS bodies will rise.

NES is already considering how best to respond to the existing drive for efficiencies. We suspect that much of the relatively easier savings will already have been achieved so that the ability of NES to respond to a prolonged wave of revenue reduction arising from the re-assessment of public spending levels and priorities is likely to be more difficult. Forecasts for the next four years should include "downside" scenarios and challenge from zero and priority based budgeting. In addition, there are lessons to be learned from other organisations that have already weathered financial challenge and crisis.

While some NHS bodies will be more vulnerable than others, all NHS bodies, including NES, will be impacted. Regardless of whether an NHS body is in a relatively stronger or weaker financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Honesty and awareness of the size of the challenge;
- Strong leadership;
- Need to engage with the whole organisation and external stakeholders;
- Realistic and detailed plans to resolve the situation;
- Rigorous implementation (programme management arrangements); and
- Financial control and discipline.

Response by NES

NES has drawn on the key messages highlighted in both Audit Scotland reports in addition to the recent report by the Chief Economic Advisor to the Scottish Government. In response, the Director of Finance and Corporate Services presented a paper, dated 27 May 2010, to the Finance and Performance Management Committee setting out the current efficiency programme for NES focussing on three areas:

- Arrangements in place to secure the SGHD target of 2% efficiency savings in 2010/11;
- Measures to achieve an additional £5 million cash saving to be returned to the SGHD in 2010/11; and
- The future financial position of NES in the medium to long term.

2% Efficiency Target

For 2010/11, NES received a 2.15% uplift in budget. As part of the budget setting process Directorates received no up-lift in budget from 2009/10 and required to demonstrate how they would deliver their objectives within this. As NES did not allocate any of the 2.15% uplift to Directorate budgets, the whole amount was retained for investment decisions by the Board. Uplifts were allocated to budgets for ACT payments and Training Grade salaries. These budget areas are excluded by SGHD when calculating NES's efficiency savings targets.

£5 Million Cash Saving

NES has been requested by SGHD to identify an additional £5 million of cash savings (non recurrent) during the course of 2010/11 to be returned to SGHD. Currently, NES has identified a £2 million saving against its RRL:

- Funds uncommitted in budget approved by the Board - £1,200,000
- 20% topslice of all new investments approved by the Board - £1,200,000

This has been offset against a potential reduction in carry forward monies of £200,000 and structural budget adjustments to cover build up of dilapidations and actuarial adjustments of £200,000.

This leaves NES with £3 million worth of savings to identify before the end of the year. NES has not, as yet, identified any further areas for specific savings. This work will progress over the coming months where management will work with each Directorate to identify and release slippage and savings.

Monitoring of this saving target will be performed by the Business Group. NES is also required to report performance against this additional savings target within its monthly financial returns to the SGHD.

Future Funding for NES in the Medium to Long Term

Further, NES has considered recent reports by the Chief Economic Advisor to the Scottish Government and the Institute of Financial Studies and identified that it could be exposed to future budget cuts of between 3% and 7.5% per annum over the next three year. NES is currently assessing and evaluating a number of measures to ensure it is well placed to manage any potential cuts in funding.

Review of Directorate Core Budget

The Business Group has requested that individual Directors re-visit their core budget allocations in order to ensure that they:

- Understand the key priorities and key cost drivers within each of their budget areas;
- Can identify any areas where there is potential to disinvest;
- Share information on efficiencies achieved and planned;
- Can identify and challenge areas of potential duplication or synergy; and
- Identify opportunities for income generation.

Use of Lean / Other Improvement Methodologies

Work is already underway in Medicine and in HR to use Lean and other methodologies to review business processes to achieve improvements. None of this work has yet reached the stage where benefits have been fully quantified.

Initial meetings have been set up with all Directorates to give an introduction to Lean thinking and to encourage Directorates to identify areas for consideration. A list of areas for potential savings was also collected during the Organisational Conference and this will be supplemented by the ideas emerging from discussions around LEAN within Directorates. In this context it is NES's aim to:

- Increase capacity without the requirement of additional resource; and
- To reduce costs – by reducing the staff time involved in processes and as a result employing less staff.

Other Efficiency Areas / Income Generation

- NES is continuing to review the 'big ticket' non-pay costs across the organisation and we will be reporting monthly to the Business Group on how these costs are being managed.
- NES is progressing work with its Property Strategy with the ambition that it will provide clear opportunities for savings through consolidation of its properties in Edinburgh and Glasgow;
- NES has developed a proposal for collaborative purchasing of e-journals with NHS Boards. This will involve NES moving, through a new tender exercise, to remove duplicates in NES purchased collections, to remove duplicates between NES and NHS Boards and to remove duplicates between NHS Boards. NES anticipate that this will generate savings for itself, but also potentially for NHS Boards; and
- As discussed in **Section 5** NES outlined its proposed approach to strategic planning over the period 2010 to 2014. This will include organisational change which should help NES better manage its staffing establishment.

Following the expected announcement of the new Coalition Government's emergency budget on 22 June 2010, NES will need to re-assess its future budget forecasts and identify with greater certainty what it has to do in order to manage its future budget allocation.

Action 3

Forecast Budget 2010/11

2010/11 Budget	£'000	£'000
Recurring income	423,500	
Recurring expenditure (before savings)	(423,500)	
Recurring efficiency savings	2,200	
Recurring underspend	<u>5,900</u>	
Underlying recurring surplus / (deficit)		8,100
Non-recurring income	10,500	
Non-recurring expenditure (before savings)	(10,500)	
Non- recurring efficiency savings	0	
Non - recurring overspend	<u>(2,900)</u>	
Non-recurring surplus/(deficit)		(2,900)
Financial surplus/(deficit) for the year		5,200
Underlying recurring surplus / deficit as a percentage of recurring income		1.91%

Figures confirmed by Audrey McColl, Deputy Director of Finance, 4 June 2010

Please note that this table does not reflect the additional in-year savings of £5m, requested by the Scottish Government, referred to on [page 19](#) of this report.

Previously, within this section, we have discussed a number of the significant cost pressures impacting NES during the 2010/11 financial year.

Additional Cost Pressure

The cumulative regional medical budget could again be exposed to potential double running costs for junior doctor grades.

In the current economic climate territorial Boards may be appointing to fewer consultant posts, increasing the risk that NES will need to support the six month period of grace for a junior doctor reaching the end of their training period, at the same time as supporting a new incumbent in the training post (double running).

Appendix A – Action Plan

Recommendation and Risk Rating	Management Response, Responsible Officer and Implementation Date
<p>Action 1</p> <p>NES should consider the suitability of the current bank reconciliation arrangements and until such time that functionality is improved put in place appropriate alternative processes that will facilitate the timely completion of month end bank reconciliations.</p> <p>Risk Rating – High</p>	<p>Management Response</p> <p>Manual reconciliations will be carried out until the issue with the auto bank reconciliation is resolved. In addition, the advertised job description for the vacant Financial Services Manager post will be reviewed to identify any factors which may be contributing to the difficulty in recruiting to this post.</p> <p>Responsible Officer: Head of Financial Services</p> <p>Implementation Date: Immediate</p>
<p>Action 2</p> <p>We recommend that those responsible for leading efficiency and improvement work at NES should formally assess themselves against each question raised in the combined Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office detailed good practice checklist.</p> <p>Risk Rating – High</p>	<p>Management Response</p> <p>Agreed</p> <p>Responsible Officer: Director of Finance and Corporate Services</p> <p>Implementation Date: September 2010</p>
<p>Action 3</p> <p>Following the expected announcement of the new Coalition Government's emergency budget on 22 June 2010, NES will need to re-assess its future budget forecasts and identify with greater certainty what it has to do in order to manage its future budget allocation.</p> <p>Risk Rating – Medium</p>	<p>Management Response</p> <p>This will be considered by NES and reported to the next Finance and Performance Management Committee in September 2010.</p> <p>Responsible Officer: Director of Finance and Corporate Services</p> <p>Implementation Date: September 2010</p>

Appendix B – Communications to Management

International Standards on Auditing (“ISA”) (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with Governance. Those charged with Governance is taken to be the Members of the Audit Committee with responsibility discharged through the regular meetings of the Audit Committee during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2009/10 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement Letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to 14 January 2010 Audit Committee and confirmed no member of audit team has any direct interest, financial or otherwise, in NHS Education for Scotland.
Audit Approach and Scope	Audit Planning document (reported to Audit Committee 14 January 2010)
Accounting Policies/Practices with a Material Effect on the Financial Statements	Sections 3 of our Annual Report to Commission Members and the Auditor General for Scotland.
Potential Effects of Material Risks and Exposures	Audit Planning document (14 January 2010).
Audit Adjustments	Section 3 of our Annual Report to Commission Members and the Auditor General for Scotland.
Material Uncertainties relating to Going Concern	None identified.
Disagreement with Management about Matters that could be Significant to the Financial Statements	Not applicable.
Expected Modifications to the Auditor’s Report	No modifications identified. A true and fair opinion provided.
Letter of Representation	Signed by Management 24 June 2010.
Material Weaknesses in Internal Control	Internal Controls findings reported separately in our Interim Management Letter (13 April 2010), Section 5 of our Annual Report to Commission Members and the Auditor General for Scotland.
Fraud	Discussed fraud arrangements with the Audit Committee (14 January 2010) and Management throughout audit process.

Communication Required under ISA 260	Reference/Comment
Laws and Regulations	We have not identified any material braches of laws and regulations in the period which impact on the 2009/10Financial Statements.
Audit Materiality	Audit Planning document – presented to Audit Committee in 14 January 2010.
Fair Value Measurement and Disclosure	Included in representation letter, signed by Management dated 24 June 2010.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.

Formal Reporting to Management during 2009/10

During the year we have presented a number of formal reports to Management and the Audit Committee and produced certain outputs. Our principal outputs during 2009/10 are summarised below:

Formal Output	Timing
Letter outlining work undertaken in relation to our review of NES's 2008/09 shadow IFRS based financial statements	February 2010
Audit Plan	14 January 2010
Detailed Timetable for 2009/10 Financial Audit	14 January 2010
Interim Management Letter Including Follow Up of Prior Year Recommendations	13 April 2010
Annual Report to Board Members and the Auditor General for Scotland	16 June 2010
Audit Opinions 1. True and fair value on the financial statements ✓ 2. Regularity of income and expenditure ✓ 3. Remuneration Report (sections) ✓	} Unqualified } Audit } Opinions 24 June 2010

Freedom of Information Act (Scotland) 2002

In the event that, pursuant to a request which the institution has received under the Freedom of Information Act (Scotland) 2002 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the “Legislation”), NES is required to disclose any information contained in this report, it will notify PwC promptly and will consult with PwC prior to disclosing such report. NES agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such report. If, following consultation with PwC, NES discloses any of this 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.

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