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Healthcare Improvement Scotland

Annual report to Members and the Auditor General for Scotland

FINAL

Year ended 31 March 2014

June 2014

PricewaterhouseCoopers
LLP
141 Bothwell Street
Glasgow
G2 7EQ

The Audit Committee
Gyle Square
1 South Gyle Crescent
Edinburgh
EH12 9EB

23 June 2014

Dear Sirs

We are pleased to enclose our report to the Audit Committee in respect of our audit for the year ended 31 March 2014. The primary purpose of this report is to communicate the significant findings arising from our audit that we believe are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit Committee in March 2014. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate. The procedures we have performed in response to our assessment of significant audit risks are detailed in Section 2.

We have completed our audit work and issue an unqualified audit opinion on the financial statements on 25 June 2014.

We look forward to discussing our report with you on 23 June 2014. Attending the meeting from PwC will be Martin Pitt and Matthew Swann.

Yours faithfully

PricewaterhouseCoopers LLP

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Section 1. Executive summary

Financial Statements

We set out in this report our significant findings from our audit of Healthcare Improvement Scotland("the Body") for 2013/14, together with those matters which auditing standards require us to report to you as "those charged with governance" of the Body.

Management responsibility

It is the responsibility of the Body and the Chief Executive, as Accountable Officer, to prepare the financial statements in accordance with the National Health Service (Scotland) Act 1978 and directions made there under. This means:

- acting within the law and 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;
- preparing financial statements timeously which give a true and fair view of the financial position of the Body and its expenditure and income for the year ending 31 March 2014; and
- preparing a Directors' Report, an Operating and Financial Review, a Governance Statement and a Remuneration Report.

Auditors' responsibilities

Our responsibilities in accordance with the Code of Audit Practice are to provide you with an audit report stating whether, in our opinion the financial statements and the part of the Remuneration Report to be audited and give an opinion on:

- whether they give a true and fair view of the financial position of the Body and its expenditure and income for the year;
- whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
- whether the information which comprises the annual report included with the financial statements is consistent with the financial statements; and
- whether expenditure and receipts have been incurred and applied in accordance with guidance from Scottish Ministers (the regularity opinion).

We are also required to review and report as necessary on other information published with the financial statements, including the directors' report, annual governance statement, statement on internal control or statement on internal financial control and the remuneration report.

Summary of the Audit

We carried out our audit work in line with our 2013/14 audit plan that we presented to you on 12 March 2014. Our audit is not designed to identify all matters that may be relevant to you. Accordingly, the audit does not identify all such matters.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

There are no unadjusted misstatements at the conclusion of our audit. We have agreed a number of minor amendments to disclosure with management and these have been fully reflected in the financial statements.

Financial performance

The Body's key financial performance for the period is as follows:

- The final outturn was £19.660m against a revenue resource limit of £19.810m, resulting in a saving of £0.150m.
- Capital expenditure in the period was £0.091m which was within the core capital resource limit of £0.095m.
- The budget for 2014/15 forecasts a revenue resource limit of £20.359m which is an increase of £0.615m (3%) on 2013/14 (£19.744m). We have not identified any key indicators or been made aware of any factors that would suggest that the Body will struggle to meet its financial targets.
- The target for cash releasing efficiency savings for the financial year 2013/14 was £0.866million of which £0.568million has been achieved from pay cost savings with an additional amount of £0.408m being found from within accommodation and other cost savings. Thus total efficiency savings of £0.976m were achieved.

Please note that copies of this report will be sent to the Audit Scotland in accordance with their requirements.

We thank the management and staff of the Body for their co-operation and assistance during the course of our work.

Section 2: Significant audit and accounting matters

We have set out in this section the significant matters arising from our audit.

Matters identified in our audit plan

Set out below is a summary of our response to matters identified in our audit plan:

Matter arising	Audit response
Fraud and management override of controls ISA (UK&I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. In any organisation, management may be in a position to override the financial controls that you have in place. The current economic conditions may also increase fraud risk.	We performed procedures to: • test the appropriateness of journal entries; • review accounting estimates for bias and evaluate whether circumstances producing any bias, represent a risk of material misstatement due to fraud; • evaluate the business rationale underlying significant transactions; and • bring an element of 'unpredictability' into our work. **We did not identify any issues to report to you as a result of our work.**

Matter arising	Audit response
Recognition of income and expenditure Under ISA (UK&I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. There is a risk that the Body could adopt accounting policies or treat income transactions in such a way as to lead to material misstatement in the reported revenue position. Due to the majority of revenue being received directly from Scottish Government we extend this presumption to the recognition of expenditure in the NHS.	We obtained an understanding of key revenue and expenditure controls. We evaluated and tested the accounting policy for income and expenditure recognition to ensure that it is consistent with the requirements of the International Financial Reporting Standards (IFRSs), as adopted by the European Union, and as interpreted and adapted by the 2013/14 Government Financial Reporting Manual (FReM). We reviewed intra NHS confirmations of balances and disputed amounts to consider the implications on our audit. We performed detailed testing of revenue and expenditure transactions, including deferred revenue, focussing on the areas of greatest risk. We reviewed significant accounting estimates and judgements for indicators of management bias. **We did not identify any issues to report to you as a result of our work.**

Misstatements and significant audit adjustments

We report to you that we have found no misstatements during the course of our audit, other than those of a trivial nature, which have not been corrected by management in the financial statements. We do not consider it necessary to bring to your attention misstatements which management have corrected as these are not deemed to be material in value or in nature.

Qualitative aspects of accounting practices

Financial statement disclosures

As part of our audit work we have reviewed, and tested, the material disclosures in the financial statements. We identified no significant issues as part of this work.

Annual Governance Statement

You are required to produce an Annual Governance Statement ("AGS") for inclusion in the Annual Report and Accounts. The aim of the AGS is to give a sense of how successfully the Body has coped with the challenges it faces and of how vulnerable the organisation's performance is, or might be, drawing on evidence on governance, risk management and controls.

We reviewed the AGS and considered whether it complied with relevant guidance and whether it was misleading or inconsistent with what we know about the Body.

We found no areas of concern to report in this context.

Other matters

An interim Chief Executive, Mr John Glennie was appointed at the Body as Interim Chief Executive in February 2013 and was in post for the entire financial year until 31 March 2014.

Section 3. Financial performance

Financial targets

The Body's performance against its three financial targets for financial year 2013/14 is set out below:

Table 1: Financial targets summary 2013/14

	Limit as agreed by SGHSCD £ million	Actual Outturn £ million	Underspend/ (Overspend) £ million
Revenue Resource Limit (RRL)	£19.810	£19.660	£0.150
Capital Resource Limit (CRL)	£0.095	£0.091	£0.004
Cash Requirement	£20.000	£19.982	£0.018

The underspend for the year 13/14 is £0.150m against the limit agreed by Scottish Government Health and Social Care Directorate (SGHSCD). The Body has an agreed variance threshold with the SGHSCD of £0.200m and so the underspend is within the agreed threshold. The Body plans to carry forward the underspend into the financial year 2014/15 to assist with the exercise of identifying efficiency savings in the longer term.

Efficiency savings

The Body has achieved £0.976m of efficiency savings in 2013/14 against a target of £0.866 per the NHS Scotland Efficient Government efficiency savings target. The sources through which the Body has achieved these efficiencies are set out below:

Table 2: Efficiency savings 2013/14

Source	Savings £ million	% of total
Pay	£0.568	58%
Estate and Facilities	£0.408	42%
Total reported	£0.976	100%

The Body reported cash releasing efficiency savings for the financial year 2013/14 of £0.976 million of which £0.568million has come from pay costs with the balance being found from within accommodation and other cost savings. The Body aims for a 5% staff turnover rate which represents a recurring saving.

The estate and facilities savings come primarily from the Body's reorganisation at Delta House and move from Elliot House to Gyle Square. The Body realised a saving in 2012 when they reduced the floor space at the Delta House site and negotiated a 50% rental discount, which has contributed a saving in the year to 31 March 2014 of £0.312m. The move from Elliot House to Gyle Square also realised an efficiency saving in the year of £0.096m.

Financial sustainability

The Financial Plan for 2014/15 identifies the following key areas of income and expenditure, recurring and non-recurring:

Table 3: 2014/15 Financial Plan*

Healthcare Improvement Scotland	2014/15 Projected £ million
Recurring income	£15.454
Recurring expenditure	£15.454
Recurring savings	£0.000
Underlying recurring (deficit)/surplus	£0.000
Non-recurring income	£4.905
Non-recurring expenditure	£4.905
Non-recurring savings	£0.000
Non-recurring (deficit)/surplus	£0.000
Financial (deficit)/surplus	£0.000
Recurring deficit as percentage of recurring income	£0.000

*The values noted in the table above are based on the assessment of management and have not been subject to audit.

Underlying recurring (deficit)/surplus

The financial plan shows recurring funding decreasing from £16.158m to £15.454m and an increase in non-recurring income from £3.652m to £4.905m.

The Body has not planned any underspends, with a break even position forecast for the next 3 years. The body will carry forward the current year underspend of £0.150m to help relieve budget pressures in 2014/15 and assist with part of its planned efficiency and productivity programme.

Future Efficiency Savings

The Body has forecast efficiency savings of £0.866m and £0.963m for years 2014/15 and 2015/16 respectively. The majority of the savings will be generated through vacant post savings. The Body aims for a 5% staff turnover rate which represents a recurring saving that will then result in them meeting their workforce efficiency saving of £0.636m and £0.642m for 2013/14 and 2014/15 respectively.

The Body will also realise efficiency savings relating to estates and facilities. The Body realised a saving in 2012 when they reduced the floor space at the Delta House site and negotiated a 50% rental discount, which delivers a saving of £0.312m per annum. The move from Elliot House to Gyle Square also realised an efficiency saving of £0.095m per annum which will contribute toward the estate and facilities efficiency savings. Other opportunities associated with premises relocation will also be considered to achieve savings as break clauses in leases occur over the next number of years.

Section 4. Governance and internal control

Governance structure

We have assessed the Body's overall governance arrangements including a review of Board and key Committee structures and minutes, financial reporting to the Board, and risk management. We have also considered key areas of risk to the Body including partnership working; service sustainability; performance management; and people management. Appropriate evidence of activity has been provided by the Body.

The Body reports on its Financial Performance on a monthly basis. This report is presented to:

- The Corporate Management Team;
- The Executive Team;
- Finance and Performance Committee; and
- The Board

The Code of Audit Practice requires us to review and report on the Body's Annual Governance Statement. The Body has used the appropriate format for its Statement and has outlined the processes it had employed to identify and evaluate risks. In addition, key elements of the Body's control framework have been highlighted.

Based on our normal audit procedures, **we agree that** the disclosures contained in the Statement are consistent with our audit findings. We consider that appropriate governance arrangements and reporting are in place.

System of internal control

The Chief Executive Officer in conjunction with management and the Audit Committee is responsible for developing and implementing systems of internal financial control and having in place proper arrangements to monitor their adequacy and effectiveness in practice.

We review these arrangements for the purposes of our audit of the financial statements and for our review of the annual governance statement and report to you any significant deficiencies in internal control that we find during our audit.

We did not identify any significant matters that, in our professional judgement, we believe we should bring to your attention.

We did note one minor control point that, in our professional judgement, we believe we should bring to your attention, as noted below:

We identified one expenditure item, which related to the year ending 31 March 2013 with a total cost of £1,295 which did not follow the appropriate procedures.

The expenditure related to hire of a venue for an event, a purchase order was not raised before the expenditure was committed with the supplier, and hence the appropriate approval process was not followed. In addition, due to a purchase order not being raised at the start of the process, the Finance Team was not aware of the cost at the year end, and as such the cost was not accrued at the year ending 31 March 2013. While trivial in value, we would emphasise the need to re-iterate to all staff the importance of following the purchase order process on all occasions.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist.

Based on audit work performed we consider the systems of internal control in place appropriate for the needs of HIS.

Risk management

As part of the audit process we reviewed the Body's operational and corporate risk registers. The risk management system, Datix, continues to be utilised by the Body. From our review of the risk registers and the processes in place we consider that the Body takes a pro-active approach to managing risk.

Internal Audit

The role of internal audit is determined by management and therefore its objectives differ from ours. Part of our overall audit approach involves gaining an understanding of the internal audit function to determine if it would be effective and efficient to use their work.

During 2013/14, the Body continued to have an outsourced internal audit function provided by Scott Moncrieff.

We have used the work of Internal Audit to gain an understanding of the controls in place within the Body that are relevant to our External Audit.

Based on audit work performed we consider the Internal Audit function within HIS to be appropriate for the need of HIS.

Section 5. Fraud

International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

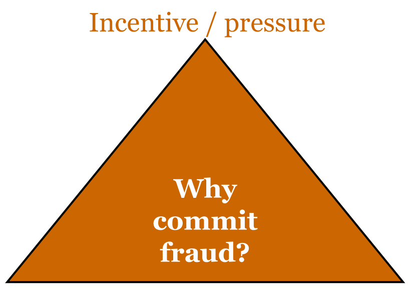
Responsibility of the Audit Committee

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

Conditions under which fraud may occur

Management or other employees have an incentive or are under pressure



Opportunity	**Rationalisation/attitude**
Circumstances exist that provide opportunity – ineffective or absent control, or management ability to override controls	Culture or environment enables management to rationalise committing fraud – attitude or values of those involved, or pressure that enables them to rationalise committing a dishonest act

Your views on fraud

In our audit plan presented to the Audit Committee on 12 March 2014 we enquired:

- Whether you have knowledge of fraud, either actual, suspected or alleged, including those involving management?
- What fraud detection or prevention measures (e.g. whistleblower lines) are in place in the entity?
- What role you have in relation to fraud?
- What protocols / procedures have been established between those charged with governance and management to keep you informed of instances of fraud, either actual, suspected or alleged?

We ask that the Audit Committee considers these questions again and lets us know if there is anything that has come to attention since the presentation of our audit plan of which we should be aware.

Prevention and detection of fraud and corruption

Based on audit work performed we consider controls in place to prevent and detect fraud or corruption to be suitable for the operations of HIS. HIS have in place an appropriate code of conduct and whistleblowing policy.

HIS have participated in the 2013/14 National Fraud Initiative program and have taken action to follow up identified matches on a timely basis.

Section 6. Independence

Independence and objectivity

We have made enquiries of all PricewaterhouseCoopers' teams providing services to you and of those responsible in the UK Firm for compliance matters.

There are no matters which we perceive may impact our independence and objectivity of the audit team.

Independence conclusion

At the date of this plan we confirm that in our professional judgement, we are independent accountants with respect to the Body, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.