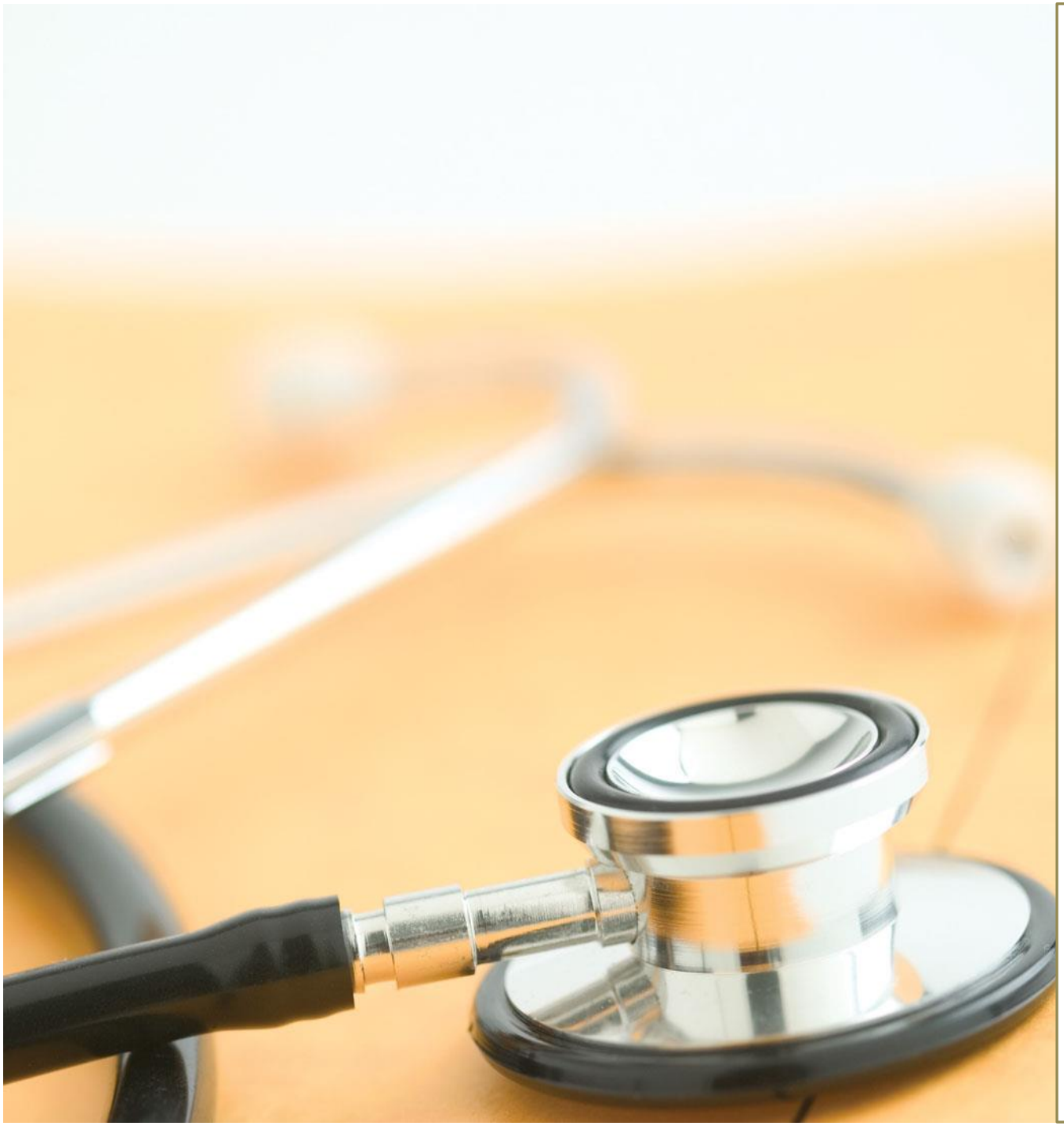

NHS Highland

Annual report on the 2013/14 audit

Prepared for the Board of NHS Highland and the Auditor General for Scotland

July 2014

Contents

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Key messages

Financial statements	• Unqualified auditor's report on the 2013/14 financial statements. • Audited financial statements submitted to Scottish Government by 30 June 2014.
Financial position and financial management	• Brokerage of £2.5 million from the Scottish Government needed to break even. • All financial targets in 2013/14 met, with surplus against total RRL of £0.088 million. • Recurrent savings of £6.977 million against £12.370 million target. • Continued reliance on non recurring savings (£11.4 million delivered against a target of £6 million) • Weaknesses in financial management at Raigmore Hospital, the extent of which emerged late in the year and contributed to the need for brokerage.
Governance & accountability	• Effective governance arrangements in place. • An effective internal audit function and anti-fraud arrangements in place.
Best Value, use of resources & performance	• In 2013/14 the Board met 17 out of 53 of its HEAT targets and standards. • A well developed framework is in place for monitoring and reporting performance.
Outlook	• The Board's financial position will remain challenging for the next five years and although a breakeven position is forecast in each of these financial years, this will only be achieved if the Board is able to deliver the required level of recurring savings needed to meet the funding gap. Robust financial management and reporting will be needed across all areas.

Financial Statements

We have given an unqualified audit opinion on the financial statements of NHS Highland for 2013/14.

The Board achieved all of its financial targets in 2013/14 and returned a surplus against its total Revenue Resource Limit (RRL) of £0.088 million. However, this was achieved only after receiving £2.5 million brokerage from the Scottish Government Health and Social Care Directorates (SGHSCD) in February 2014. The Board reported that its financial position was negatively affected by the cost of locum medical staff and expenditure it incurred as it sought to meet treatment access targets. It was also reported that one of the SGHSCD's reasons for agreeing brokerage arrangements was that there should be no impact on patient services in the Highlands. The Board has agreed a repayment profile over three years with £0.5 million due to be repaid in 2014/15.

Additional funding of £1 million was also received from The Highland Council to alleviate cost pressures around adult social care services. This is part of an updated three year funding arrangement with the Council which will see it providing a further £4 million recurring financial contribution to the Board.

The Board achieved recurrent savings of £6.977 million against a planned savings target of £18.37 million. Whilst it also delivered a further £11.39 million on a non recurring basis, the additional cost pressures in relation to access targets and locum costs as well as the Raigmore overspend resulted in the need for brokerage this year.

Financial position and financial management

Weaknesses in budgetary control at Raigmore Hospital led to it reporting a £9.65 million overspend in the year. Officers reported to the Audit Committee, that there is no certainty that these weaknesses are not replicated across other operating units, although the year end financial outturn reported that overspends were mostly confined to Raigmore.

As noted, the Board required brokerage funding of £2.5 million in order to break even. However, this was not formally reported to Board members until April 2014. The Board's financial plan for 2013/14 included the need to deliver against savings targets in order to break even, but these savings plans were not sufficiently detailed. The July 2013 forecast savings requirement showed a need for £10.8 million " management planned actions" to deliver a balanced position. A year end break even continued to be forecast by the Board until February 2014, although the in-month financial position was in deficit each month, peaking at £5.1 million in December 2013. Finance reports did not sufficiently detail how the Board expected to bridge the gap between the in month position and the forecast break even.

The Board has been increasingly reliant on non-recurrent savings in order to secure break even in recent years and as a result, unmet savings of £8 million have been carried forward into 2014/15. The Board's 2014/15 Local Delivery Plan (LDP), which was submitted, to the SGHSCD in February 2014, assumes a phased return to recurring balance over three years and includes an overall savings requirement of £21.9 million in the year, £3.7 million of which

would be on a non recurring basis. However, the Board expects to deliver more non recurring (and therefore less recurring) savings during the year and anticipates an underlying deficit of £6 million at the end of 2014/15. Whilst this would be an improvement on the deficit for 2013/14 of £8 million, reducing this gap will continue to present significant challenges to the Board.

The financial plan includes indicative recurring savings of £18 million and £26 million for 2015/16 and 2016/17 respectively. A further £4 million of non recurring savings in 2015/16 and £2 million in 2016/17 will also be needed. Together with the need to repay brokerage to SGHSCD, delivering a breakeven budget over the coming years will be challenging for the Board. It plans to deliver the required savings through a combined approach of traditional savings and by further embracing the quality agenda to reduce waste and improve productivity.

Governance and accountability

In 2013/14, the Board had effective governance arrangements with the standing committees overseeing key aspects of governance. It also had an effective internal audit function and anti-fraud arrangements.

Audit Scotland's report on the management of patients on NHS waiting lists found limitations in the systems used to provide an audit trail on how waiting lists were managed. A local review of waiting times carried out by internal audit identified some areas for improvement. The Board has provided written assurance to the Scottish Government that improvement actions identified by internal audit have been implemented.

NHS Highland and The Highland Council signed a partnership arrangement in 2012 to provide integrated health and social care services. A lead agency approach was adopted with NHS Highland taking responsibility for adult community care services and The Highland Council taking the lead on children's services. Both bodies have joint responsibility for specifying the outcomes to be achieved and the total resources allocated to these two service areas. The financial pressures of integration relating to adult social care remain a risk for NHS Highland. Until resolution of the matter in February 2014, the cost of proving adult care services was a significant cost pressure for NHS Highland and represented a risk to the achievement of its financial objectives. Its brokerage funding from the SGHSCD may have been higher had this settlement not been reached. We noted in our 2012/13 annual audit report that the Board would face financial pressures in respect of the delivery of adult care services as a result of the flat funding settlement for local government. The 2013/14 budget included a requirement for the Board to make £3.7 million savings for adult services. Actual savings were £3.3 million. This shortfall contributed to the Board's challenging financial position.

The lead agency arrangements with The Highland Council do not include services for residents in Argyll and Bute and the Board has recently agreed a body corporate arrangement with Argyll and Bute Council for these services, in accordance with the requirements of the Public Bodies (Joint Working) (Scotland) Act 2014.

Best Value, use of resources and performance

The Board has a well developed framework in place for monitoring and reporting performance. The Board's Improvement Committee has a remit to review performance against national targets and it provides an assurance report to the Board highlighting any areas of concern and the actions being taken to address the risks.

The Board reported achieving only 17 out of 53 HEAT targets and national/local standards in 2013/14. Performance against a number of access targets including, Cancer, 12 week Outpatients and the 9 week admissions waiting time targets, plus the 12 week Treatment Time Guarantee had deteriorated through the year.

The Board has arrangements in place to consider national performance reports issued by Audit Scotland, whereby local performance is assessed against national findings and improvement actions identified. These actions are reported to the Audit Committee.

Outlook

The Board is predicting a balanced budget position in each of the financial years from 2014/15 to 2018/19. However, this is dependent on the delivery of efficiency savings each year to compensate for the gap between available funding and the cost of services. The level of flexibility within expenditure budgets is considerably reduced by the release of cost savings in previous years. The Board will continue to operate in a funding environment which is subject to sustained pressure to deliver more with less. Achieving sustainability in the medium term will require robust financial management, innovation and vision to design and deliver the services needed to serve the future needs of citizens.

Introduction

This report is a summary of our findings arising from the 2013/14 audit of NHS Highland. The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.

Our responsibility, as the external auditor of NHS Highland, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

The management of NHS Highland is responsible for:

- preparing financial statements which give a true and fair view
- implementing appropriate internal control systems
- putting in place proper arrangements for the conduct of its affairs
- ensuring that the financial position is soundly based.

This report is addressed to the Board and the Auditor General for Scotland and should form the basis of discussions with the Audit Committee as soon as possible after it has been issued. Reports should be made available to stakeholders and the public, as audit is an essential element of accountability and the process of public reporting.

This report will be published on our website after it has been considered by the Board. The information in this report may be used for the Auditor General's annual overview of NHS financial performance. The overview report will be published and presented to the Public Audit Committee of the Scottish Parliament later this year.

A number of **local and national reports** have been issued during the course of the year. These reports (detailed in **Appendix I**) include recommendations for improvements. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of NHS Highland.

The concept of audit risk is of key importance to the audit process. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. We set out in our annual audit plan the related source of assurances and the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix II** sets out the **key audit risks** identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

Appendix III is an **action plan** setting out the issues, risks and recommendations arising from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response".

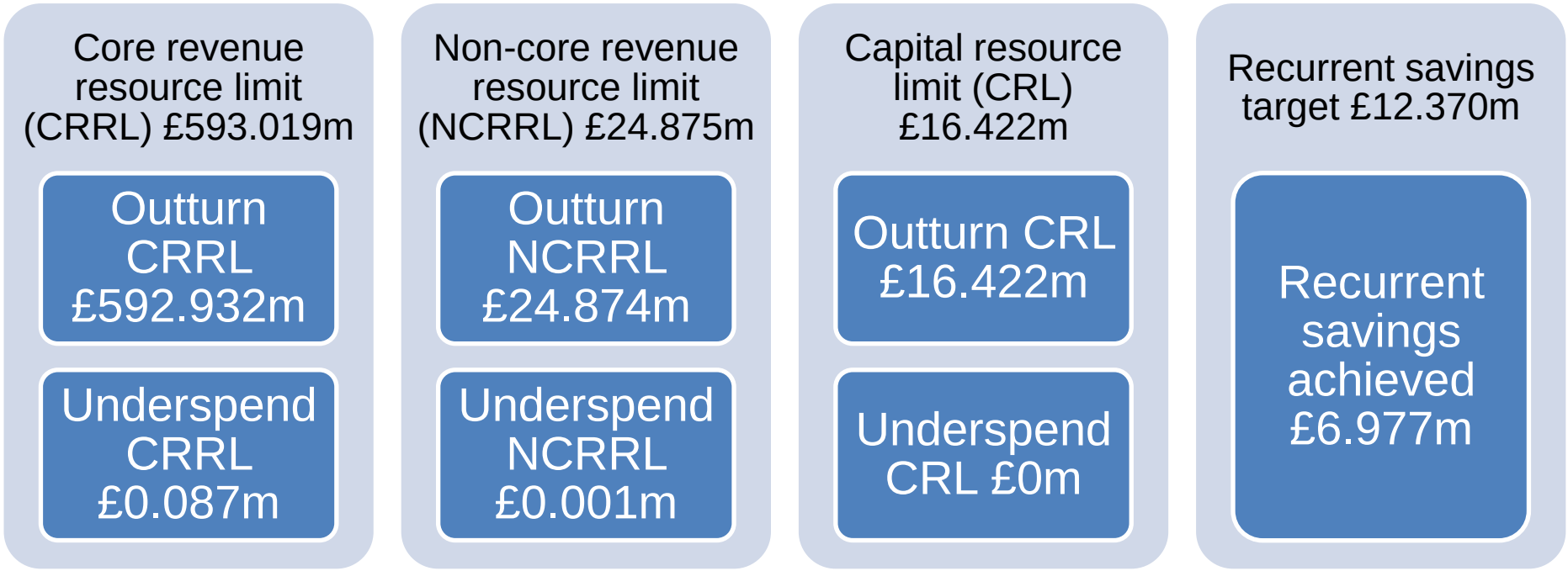
Appendix IV outlines some of the financial pressures faced by the Board.

We recognise that not all risks can be eliminated or even minimised. What is important is that NHS Highland understands its risks and has arrangements in place to manage them. The Board and Accountable Officer should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and monitor outcomes.

We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged

Financial statements



Audit opinion

We have given an unqualified opinion that the financial statements of NHS Highland for 2013/14 give a true and fair view of the state of the affairs of the Board and its group and of their net operating cost for the year.

Other information published with the financial statements

Auditors review and report on other information published with the financial statements, including the Directors' Report, Governance Statement and the Remuneration Report. We have nothing to report in respect of these statements.

Regularity

The Public Finance and Accountability (Scotland) Act 2000 requires auditors to certify that, in all material respects, the expenditure and income shown in the accounts was incurred or applied in accordance with relevant legislation and guidance issued by Scottish Ministers. We addressed the requirements of the Act through a range of procedures, including obtaining written assurances from the Accountable Officer. We have given an unqualified opinion on regularity in our 2013/14 auditor's report.

Accounting issues arising

We received the unaudited accounts template for the Board's financial statements on 6 May 2014 in accordance with the agreed timetable, however this did not include the endowments funds which required to be consolidated within the Board's accounts for the first time this year. We then received the unaudited consolidated template including endowment funds on 12 May 2014 and the remaining sections of the financial statements i.e. Operating and Financial Review, Directors Report, Strategic Report, Accounting Policies, Remuneration Report and Annual Governance Statement, on 20 May 2014. The impact of the late receipt of part of the financial statements was offset by the high standard of working papers and good support provided to the audit team by Health Board staff. This enabled us to complete our audit on time and meet the reporting deadlines. ***(Action plan no 1)***

A number of disclosures, presentational and monetary adjustments were identified in the financial statements during the course of our audit. These were discussed with management who agreed to amend the unaudited financial statements. The effect of these adjustments was to decrease total comprehensive expenditure by £4.677 million and decrease net assets by £1.733 million. The more significant changes related to:

- £1.733 million (unrealised losses on pension costs) which were included in net operating costs and should have been shown in other comprehensive net expenditure. This was also required to be included as a liability in the Board's balance sheet.
- £4.800 million (unrealised gain on revaluation of property plant and equipment) which had been omitted from other comprehensive net expenditure.
- £0.102 million (unrealised gain on endowments assets) which had been included in net operating costs but should have been shown under other comprehensive net expenditure.

In addition, two other unadjusted errors (totalling less than £0.1 million) were identified during the course of the audit, where if adjusted these would have a net effect of decreasing by £96,000 the net operating costs for the year shown in the Statement of Consolidated Comprehensive Net Expenditure and increase net assets on the Balance Sheet by £96,000. This would also have had an impact on the reported saving against the Core Revenue Resource Limit which would have increased by £96,000 to £165,000. It is our responsibility to request that all errors be

corrected although the final decision on this matter rests with those charged with governance taking into account advice from officers and materiality. Management explained that these differences were not material to the financial statements or achievement of the Board's financial objectives.

Report to those charged with governance

On 25 June 2014, we presented our report to those charged with governance (ISA 260) to the Audit Committee. The primary purpose of this report is to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. The main points are set out in the following paragraphs.

Abandoned projects - Capital Resourcing Limit (CRL) impact

Two capital schemes with a net book value of £17,700 were treated by the Board as a sale by disposal this year. Disposals are taken into account when calculating whether or not a Board has achieved its CRL. However, our audit identified that these were projects that had been abandoned by the Board as no longer being required. Consequently, these costs should have been impaired and not treated as disposals. This was agreed with officers and an adjustment was made to the accounts. The impact of this amendment would have resulted in an overspend against the CRL, but officers subsequently identified that the unaudited accounts incorrectly included a balance of £18,000 that had been over accrued against a capital project this year. This related to capital work that had not been received in year and was effectively a 2014/15 payment. As a result the Board remained within its CRL limit for 2013/14.

Pension fund actuarial gains and losses

The Board became an admitted body of The Highland Council Pension Fund in 2012 following agreement of the lead agency partnership arrangement for integrated adult social care which lead to council staff transferring to the Board. The Board included details of pension costs, assets and liabilities for these staff in line with International Accounting Standard 19 – Employee Benefits (IAS19). Unrealised actuarial losses of £1.733 million were incorrectly shown in the Net Operating Costs in the draft accounts and, as highlighted above, an adjustment was required to correctly reflect these in other comprehensive net expenditure.

The Board received Annually Managed Expenditure (AME) funding from the Scottish Government for IAS19 pension costs that impact on the net operating costs and in the initial draft accounts this included the £1.733 million. However, as these unrealised losses did not impact on the net operating costs an AME adjustment was also required. The Board had to establish a long term liability for the unrealised element of these costs. As a result the " other reserves" in the Statement of Changes in Taxpayers Equity statement no longer agrees to the overall pension liability because part of this is funded by Scottish Government. This is a complex accounting area and the NHS accounts template does not enable a clear disclosure to be made. The Board has included a

reconciliation in Note 24 to the accounts to show how the IAS19 pension costs have been reflected in the accounts.

The Board will need to discuss with both the SGHSCD and the Technical Accounting Group how these pension costs can be better reflected in the financial statements going forward (***Action plan no 2***)

Endowments funds

The 2013/14 accounts manual required host boards to consolidate NHS endowment funds established by the National Health Service (Scotland) Act 1978, where material, into their financial statements. The Highland Health Board Endowment Funds have been consolidated into NHS Highland's financial statements for 2013/14. The basis of consolidation is merger accounting with any intra-group transactions between NHS Highland and the endowment funds eliminated on consolidation. The consolidation required the restatement of prior year comparative figures and the inclusion of a consolidated opening balance sheet at 1 April 2012. The endowment funds figures used in the consolidation process were based on a draft set of endowment fund accounts prepared on 1 May 2014. The audited accounts were signed on 25 June; no changes were required to draft endowments accounts figures.

Equal pay

The National Health Service in Scotland has received in excess of 9,000 claims for equal pay of which 165 relate to NHS Highland. Such claims are referred to the NHS NSS Central Legal Office (CLO).

In common with other NHS boards, NHS Highland has not been able to quantify the extent of its liability for equal pay claims and has disclosed a contingent liability in the accounts in line with advice from the CLO. Whilst the risk is reducing over time, these claims may have an adverse impact on the financial position and the Board continues to maintain links with the SGHSCD and CLO to keep up to date with progress being made in settling Equal Pay Claims.

Outlook

The financial statements of the Board are prepared in accordance with the Government financial reporting manual (the FReM). The main new standards adopted in 2014/15 are:

- IFRS 10 Consolidated financial statements
- IFRS 11 Joint arrangements
- IFRS 12 Disclosures of interests in other entities.

Compliance with the FReM is mandatory; however, the impact of the adoption of the new standards is unlikely to be significant to the financial statements of NHS Highland.

Financial position and financial management

NHS Highland is required to work within the resource limits and cash requirement set by the SGHSCD. Final RRL and CRL were agreed with SGHSCD on 25 April, after the 2013/14 year end. The Board achieved all of its financial targets in 2013/14, but required brokerage of £2.5 million from SGHSCD to support the financial position. Additional funding of £1 million was also received from The Highland Council to alleviate cost pressures around adult social care services. This was part of an updated three year funding arrangement with the Council which will see it providing a further £4 million recurring financial contribution to the Board from 2014/15.

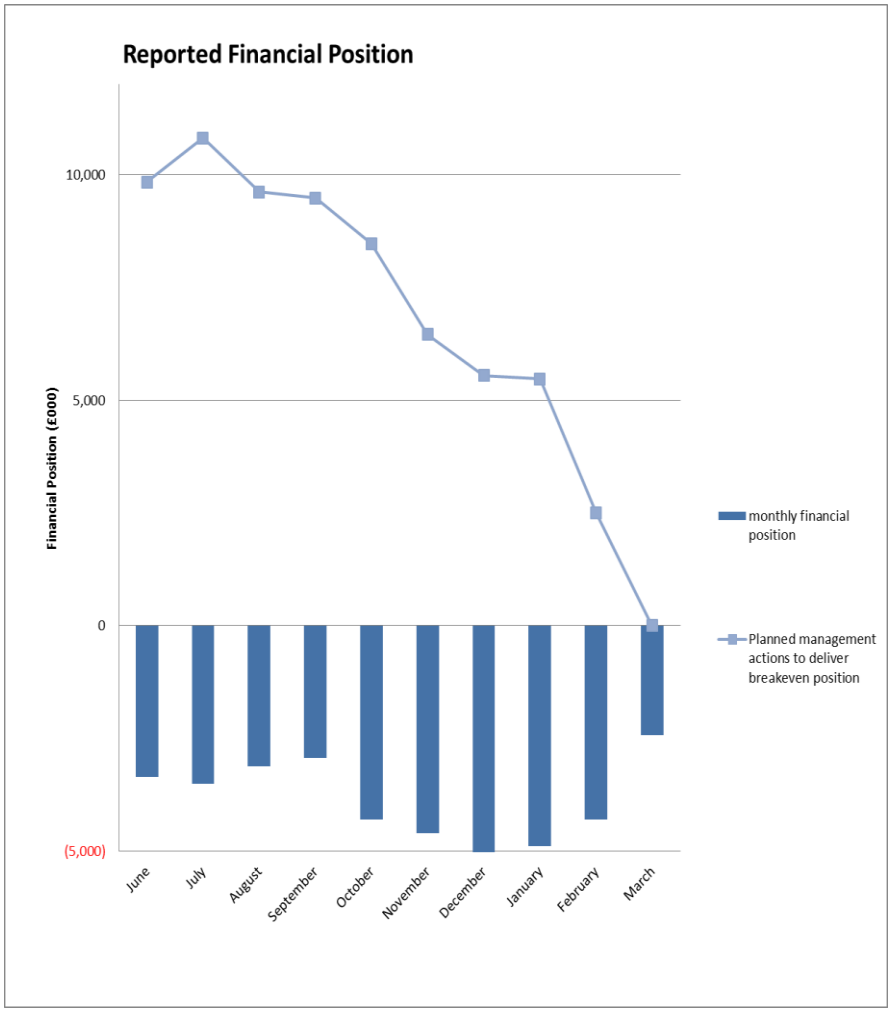
The Board had budgeted to break-even against its RRL in 2013/14 and reported a cumulative surplus of £0.088 million for the financial year. Despite this small surplus, the Board had an underlying deficit of £8 million, which represented the excess of recurring expenditure commitments, over recurring funding and savings, carried forward into 2014/15. NHS Highland, has historically, relied upon a measure of non-recurring funding to achieve financial targets. However, due to the one-off nature of this type of funding, the tighter financial settlement compared to the past and reduced flexibility within expenditure budgets, there is less scope for reliance on non-recurring income to achieve financial balance. The Auditor General for Scotland's NHS financial performance 2012/13 report drew attention to NHS Highland's high risk strategy of making significant use of non recurring savings to support its financial balance. In the LDP and financial plans the Board recognises that they must return to achieving financial balance on a recurrent basis and that reliance on non-recurring savings is not sustainable.

The Board faces a number of on-going cost pressures, some of which are outlined in appendix IV.

Financial management

The Board's financial monitoring report for the year to 28 February (reported to the Board in April 2014) forecast a year end deficit of around £2.5 million, which it attributed to significant medical locum costs and delivery of access targets.

Monthly monitoring reports reported to the Board forecast a year end breakeven position throughout 2013/14. However, the actual year to date outturn position, showed significant overspends against the budget each month, as can be seen from the diagram below. Monthly monitoring packs prepared and issued to senior management and the SGHSCD reported that the deficit would be made up from 'management planned actions'; however no detailed actions were provided as to how the Board was planning to achieve the year end breakeven position. NHS Highland was unable to make all of the required savings and management actions which resulted in the need for brokerage from the SGHSCD. **(Action Plan no 3).**



The £9.65 million overspend at Raigmore was a significant contributor to the year end outturn. In May 2014 internal audit raised concerns about poor budget management arrangements at the hospital and that budget holders were neither actively managing their budgets nor being held to account for them. Senior management accepted internal audit's findings, but noted that they would not be resolved in the short term and a three year recovery plan has been developed to resolve the issues. It is not clear whether this situation is prevalent across other operating units although the year end financial outturn reported that overspends were mostly confined to Raigmore. The Board has asked the internal auditors to undertake similar reviews across the three other operational units, beginning with the North & West unit in 2014/15. Management advised us that the full extent of the financial overspending and weaknesses in financial controls at Raigmore emerged late on in the financial year following the appointment of a new management team in December 2013. This meant there was not sufficient time to take the necessary remedial steps to meet the Board's financial targets in 2013/14. (**Action plan no 4 & 5***)*

Capital expenditure

The Board spent a total of £16.422 million on capital projects during 2013/14 which was its full CRL allocation. The majority of this expenditure related to on-going work on assets under construction.

Financial sustainability

Historically, boards have relied upon a measure of non-recurring funding to achieve financial targets. There is a risk that over reliance on non-recurring income to achieve financial balance becomes unsustainable. Longer term financial plans should be

based upon recurring expenditure streams as a basis for reviewing and redesigning models for service delivery.

The Board's draft LDP for 2014/15 aims to align strategic priorities with financial plans, workforce plans and asset management plans, although it's not clear how the financial, workforce and asset management plans link together. Its financial planning arrangements include regular monitoring, reporting and updating of financial information in the form of monthly monitoring reports circulated to Board members. The financial position is reported to the Board in the form of area finance reports which note the financial forecast and progress on savings plans for the year to date.

The Board's five year financial plan for the period 2014/15 to 2018/19 indicates a break-even position in each of the five years. The plan assumes efficiency savings of around £22 million in 2014/15 and 2015/16, £28 million in 2016-17 and £17 million in the final two years. Anticipated future funding uplifts are in the range of 2.7% for 2014/15 and 1.8% thereafter.

The Board reported through the 2014/15 LDP that all of the £21.9 million savings required have been identified for the year with £3.7 million of these being on a non recurring basis. There remains a risk, however, that these efficiency savings are not delivered and the Board should ensure detailed formal plans are produced covering all the required savings for 2014/15 as a priority. ***(Action plan no 4).***

The Board identified recurrent savings of £1.6 million as part of asset lives re-profiling in 2013/14. As a result of changes to assets lives the Board will incur additional expenditure for the maintenance of these assets. In 2013/14 these costs were covered by a capital to revenue transfer, however in future years any additional maintenance costs will need to be covered from existing revenue resources adding additional budget pressures.

Integration of adult health and social care

The financial pressures of integration relating to adult social care remain a risk for NHS Highland. In the last two years the SGHSCD and the council have allocated additional funding to the Board to help alleviate these pressures and further recurring funding over and above the core quantum of around £87 million has been agreed with The Highland Council. In addition, the Board has agreed an additional £1.5 million non recurring funding with the council for 2014/15. (***Action plan no 4)***

Workforce pressures

As with other health boards, NHS Highland faces a major challenge in achieving the national sickness absence target of 4%. Following the transfer of more than 1600 staff from The Highland Council as part of the integration of adult social care services, there was an increase in the level of sickness during 2012/13, rising to 4.9%, from 4.5% in 2011/12. It fell marginally in the year to March 2014 to 4.8%. **(*Action plan no 6).***

During 2013/14 the Board incurred significant costs in relation to agency staff. Costs increased from £5.275 million in 2012/13 to

£9.593 million, an increase of 82%. Overall the number of locums employed rose from 52.7 wte in 2012/13 to 92.1 wte in 2013/14. In recent years the Board has relied on medical locums to fill vacant posts. NHS Highland faces continued challenges in recruiting staff in rural areas, in particular consultants, GPs, higher band nurses and pharmacists. Continued reliance on agency staff to this extent will have a significant impact on the Board's plans to achieve the savings required for longer term sustainability. **(*Action plan no 7).***

Cost of pension provision

Following the advice of the Scottish Government, Note 24 in the financial statements for 2013/14 "Pension Costs" reports a net liability of £370 million for the NHS Superannuation Scheme arising from the most recent actuarial valuation. This figure is based on the last quinquennial actuarial valuation on the NHS Superannuation Scheme which was for the year ended 31 March 2004. While there was a more recent actuarial valuation carried out at 31 March 2008, the publication of this valuation has been postponed by HM Treasury pending the outcome of public sector pension reforms. In future, potential increases to contribution rates will need to be managed as part of the cost base.

Changes in pension legislation came into force in 2012 which require all eligible employees to be automatically enrolled into a workplace pension scheme. Employer's pension contributions will also increase from April 2015. All employees between 22 and state pension age who earn more than the earnings trigger will be automatically enrolled in the NHS Pension Scheme. The Board has incurred costs of around £1million in relation to auto enrolment of staff into the pension scheme.

PFI/ PPP costs

NHS Highland has three PFI/PPP contracts, New Craigs, Easter Ross and Mid Argyll Community Hospital, which are disclosed in Note 22 to the accounts. The contracts are reported on-balance sheet at a combined value of £42.4 million. The associated recurrent revenue cost of these schemes is £6.661 million with a total future commitment recorded in the balance sheet of £34.185 million.

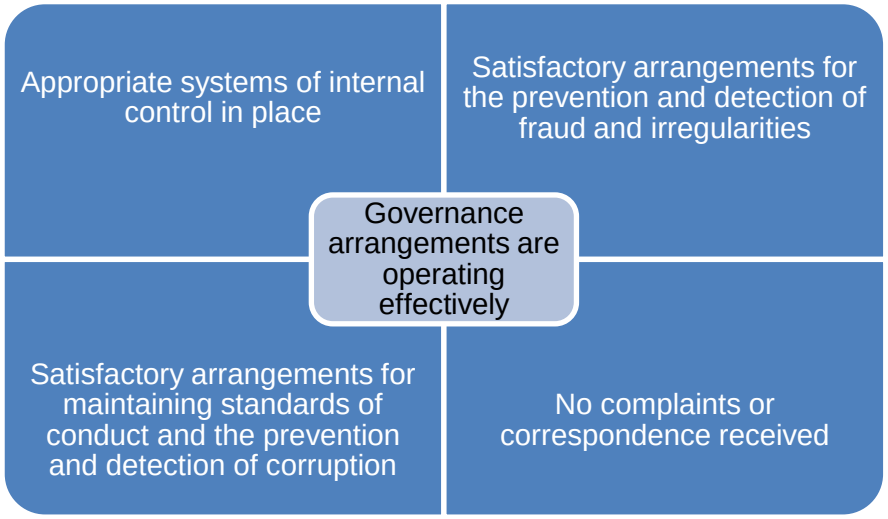
Outlook

The Board is predicting a balanced budget position in each of the years from 2014/15 to 2018/19. However, this is dependent on the delivery of efficiency savings each year to compensate for the gap between available funding from current sources and the cost of services. The Board will continue to operate in a funding environment which is subject to sustained pressure to deliver more with less. The level of flexibility within expenditure budgets is considerably reduced by the release of cost savings in previous years. The cost of pension provision, adult social care, and liabilities in respect of equal pay compensation are issues which will impact on the future financial position of the Board.

The updated National Resource Allocation position was published earlier this year. NHS Highland is approximately £13 million below

its target share in terms of baseline funding under the NRAC Parity funding. The Board will receive an additional £2.5 million of NRAC Parity Funding in 2014/15 with a further £10.5 million allocation estimated over the next two years. In addition, £5.5 million additional funding (£4 million recurring as part of the three year agreement) has been agreed with The Highland Council for adult social care costs in 2014/15.

Governance and accountability



The Board and Accountable Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of NHS Highland and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

The corporate governance framework within NHS Highland is centred on the Board which is supported by a number of standing committees. Based on our observations and audit work our overall conclusion is that the governance arrangements within the Board are operating effectively.

- Audit Committee
- Staff Governance Committee
- Clinical Governance Committee
- Improvement Committee
- Remuneration Sub Committee

Internal control

As part of our audit we reviewed the high level controls in a number of NHS Highland systems that impact on the financial statements. This audit work covered payroll, general ledger, banking, trade receivables, trade payables and family health services. Our overall conclusion was that NHS Highland had appropriate systems of internal control in place during 2013/14.

Internal audit

Scott Moncrieff, the Board's internal auditors provide the Board and Accountable Officer with independent assurance on the overall risk

management, internal control and corporate governance processes. In addition, in an effort to avoid duplication, we place reliance on internal audit work where appropriate. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work.

Our review of the internal audit service concluded that it operates in accordance with Government Internal Audit Standards and has sound documentation standards and reporting procedures in place. In 2013/14 we took assurance from internal audit work on capital accounting.

ICT audit

Integrated Care Highland is one of the main areas of challenge for eHealth. Providing access for adult social care staff to information technology resources such as email and records management systems can be difficult in locations where there is little to no IT, such as care homes. This can lead to duplication of information recording (handwritten notes that will later require to be recorded in electronic patient records).

The Board's eHealth department successfully implemented the new Patient Management System (PMS) in March 2014. This system holds patient records relating to hospital visits and admissions. The implementation was a migration of two previous patient administration systems, Helix and iSoft. The department is still dealing with teething problems, particularly relating to up-to-date base information, reporting and data quality of the information. The data quality problems are currently being analysed for root causes (technological or user related) and additional training is under consideration. The next phase of the PMS implementation will cover real time bed management and order communications, the electronic ordering of clinical tests.

NHS Highland has a large number of Windows XP PCs. The support for PCs running this operating system has been withdrawn, with an extended contract finishing in March 2015. Investment of £1.4 million is required to replace or upgrade existing PCs as well as staff costs to carry out the required work. As part of normal turnover, around 1,400 of 6,000 PCs have been upgraded to Windows 7.

The eHealth Strategy Group which discusses and monitors strategic eHealth matters is planning an additional meeting in the summer of 2014 to prepare its updated eHealth Strategy and Local Delivery Plan.

Arrangements for the prevention and detection of fraud

Overall we found the Board's arrangements in relation to the prevention and detection of fraud and irregularities are satisfactory.

NHS Highland participates in the National Fraud Initiative (NFI). The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might

indicate the existence of fraud or error. Overall, we concluded that the Board has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI. There had been some delay in concluding the NFI exercise due to a key officer being on long term sickness during the early part of the year and further improvements could also be made by updating the standing financial instructions to include NFI, working closer with Counter Fraud Services when potential fraud cases arise and including internal audit in the review. We also noted that staff transferred to the Board as a result of integration of adult health and social care (see below) had been subject to Highland Council policies in relation to fraud during 2012/13. In 2013/14 these staff still had not received any specific training on the Board's fraud policies although they had been made aware of where the policies could be found. (***Action plan no 8)***

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

The arrangements for the prevention and detection of corruption in NHS Highland are satisfactory and we are not aware of any specific issues that we need to record in this report.

Correspondence referred to the auditor by Audit Scotland

No correspondence was received.

Integration of adult health and social care

The Public Bodies (Joint Working) (Scotland) Act 2014 received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland and it offers some flexibility on the partnership arrangements for the governance and oversight of integrated health and social care services.

New partnership arrangements between NHS Highland and The Highland Council to provide integrated health and social care services became operational on 1 April 2012, two years ahead of any other health board. Over 1600 staff transferred from the council to the Board as a result of the partnership agreement and around 200 transferred from the Board to the council.

The current lead agency arrangements do not include services at Argyll and Bute and the Board has recently agreed on the alternative option of a body corporate arrangement which will come into effect from 1 April 2015 with Argyll and Bute Council for these services.

Equality Act 2010

The Equality Act 2010 introduced a new public sector 'general duty' which encourages equality to be mainstreamed into public bodies' core work. To allow the public to assess an organisation's performance on equality the Act requires publication of information on actions taken and the progress made to achieve equality outcomes. The Board must review its outcomes and publish a

review by April 2015.

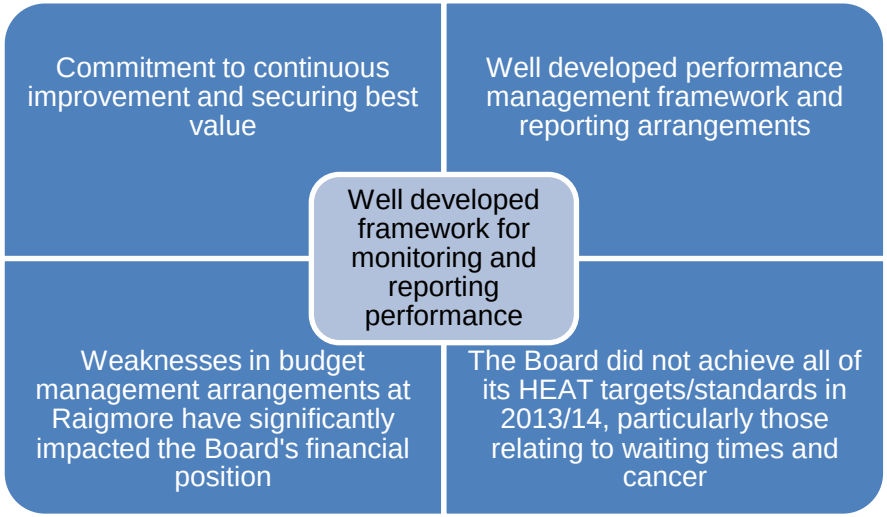
The Board has worked to ensure that the duties under the Equality Act have been used to further the Highland Quality Approach's aim of Better Health, Better Care and Better Value. The Board's Mainstreaming Equality (published April 2013) sets out the progress and plans made by the Board in meeting the requirements of integrating equality.

We have concluded that the Board is committed to implementing the requirements of the Equality Act 2010 and has made good progress in mainstreaming equality and diversity within the organisation

Outlook

Integration of health and social care is a complex and challenging process and the Board will need to continue to engage at the highest level with Argyll and Bute Council to ensure that the unified service is in place for Argyll and Bute residents by the statutory date of 1 April 2015. The financial position for the lead agency arrangement with The Highland Council is likely to continue to be a challenge for both organisations going forward and will require close monitoring to ensure the aims and objectives of the lead agency agreement are delivered.

Best Value, use of resources and performance



Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value (BV).

Arrangements for securing Best Value

The Board has well-established arrangements for securing BV and commitment to continuous improvement. In 2012/13 it developed a best value assurance framework to map activities and sources of assurance against the Scottish Government's best value themes of:

- Vision and leadership
- Effective partnerships
- Governance and accountability
- Use of resources
- Performance management.

In addition, this best value framework covers cross-cutting themes of Equality and Sustainability.

We are satisfied that the Board can demonstrate a clear commitment to BV and continuous improvement, however it continues to face on-going challenges in delivering efficiency savings which, if not addressed, could adversely impact on service delivery.

Use of resources: financial planning

Unidentified savings of between £6 million and £10.9million have been highlighted in section 4 of the Board's LDP for the four years from 2015/16. The Board has recognised the significant challenges it faces in achieving these and is actively looking to identify savings. A Programme Board, chaired by the Chief Executive and including all Executive Directors and Operational Directors, has been established to oversee the delivery of the savings. The focus is on delivering recurring savings to achieve financial balance.

The financial position has been worsening in recent years and the

Board has struggled to make recurring savings to resolve it. A major factor is the overspend position at Raigmore (£9.65 million in 2013/14) and a three year recovery plan is being developed to address the issues. (***Action plan no 4)***

Use of resources: workforce planning

Workforce planning forms one of the strategic arms of the corporate planning process which supports the Board's three dimensional (integrated service, financial and workforce) approach to the LDP. However, it is not clear how all of the financial, workforce and asset management plans link together.

The Board agrees an annual workforce plan which takes account of demographic changes over the next 20 years.

In its LDP for 2013/14, the Board outlined the following key workforce risks and challenges, which were generally unchanged from previous years:

- The vulnerability and sustainability of Rural General Hospitals due to recruitment and succession planning challenges in medical staffing and on-going high medical locum use.
- Workforce sustainability issues in GPs with a number of vacancies across rural GP practices.
- Recruitment and succession planning for small specialties.
- Ageing workforce.

The Highland Quality Approach is driving service change and redesign aimed at delivering changes to workforce skill mix and freeing up consultant time so that care can be led, planned and delivered in the most efficient way, by the most appropriate healthcare professional.

The Board is focussing on the following three aspects to maintain workforce affordability:

- Reducing expenditure on flexible workforce i.e. bank, agency, locums, overtime and extra hours costs.
- Reducing the workforce cost base i.e. excess basic hours, waiting time premia, extra programme activities (medical), on-call and unsocial hours, working hours, travel (through the use of IT) and subsistence reduction.
- Improving productivity and efficiency i.e. reducing sickness absence, developing staff wellness initiatives, effective use of PIN policies, improved job planning, effective use of travel time; and implementing technological solutions and service improvement.

The Board is currently preparing its workforce plan 2014/15 which will focus on workforce development and workforce contribution to quality improvement and service redesign with links to operational unit delivery plans. The plan will consider changes in demographics of both patients and staff over the long term. It is anticipated that this will be presented to the Board in August 2014.

Use of resources: asset planning

An Asset Management Group is in place with a key element of its remit to develop a rolling five year asset management plan and an asset management strategy. The Board is consulting on potential service redesigns in Badenoch & Strathspey and Skye, Lochalsh & South West Ross. Its preferred option would see a new hospital in Aviemore, a new hospital in Broadford and a Primary Care Emergency Centre in Portree.

National performance audit reports

The Board has arrangements in place to consider national performance reports issued by Audit Scotland, whereby local performance is assessed against national findings and improvement actions identified. These actions are monitored by the Audit Committee to confirm implementation. A summary of national performance audit reports is included in appendix I.

Management of patients on NHS waiting lists

Audit Scotland carried out a review of waiting times across the health service in Scotland following reported misuse of patient unavailability codes at NHS Lothian. The review recognised the need for independent assurance on the management of waiting times to restore public confidence in the system.

A follow up review was published in December 2013. The review found that the trend of reducing use of unavailability codes noted in the original report continued during 2012 and 2013. The review also noted that Boards were improving controls and audit trails in the systems used to manage waiting lists. In particular, there is a stronger focus on how boards record and monitor the reasons for patient unavailability.

The follow up report, which was considered at the December 2013 Audit Committee, highlighted that NHS Highland was the only Board not reporting a breakdown of patient-advised codes for inpatients to ISD Scotland. This was due to limitations in the Board's electronic system. The system was upgraded in March 2014 and this information is now being reported to the Improvements Committee.

Management of patients on NHS waiting lists- audit update, December 2013

Boards should:

- ensure their management of waiting lists includes scrutinising how they use all waiting list codes, not just unavailability codes
- implement the national controls framework to assess whether they have all the necessary controls in place to manage waiting lists, and address the gaps they need to fill
- implement our previous recommendation about making sure they identify patients with additional support needs and provide the required support
- ensure letters to patients about the treatment time guarantee provide clear and detailed information
- use the new codes to monitor unavailability due to patient choice reasons as part of their overall capacity planning
- use the tool being developed by ISD Scotland to monitor indicators for the management of waiting lists and benchmark their performance against other boards.

Performance management

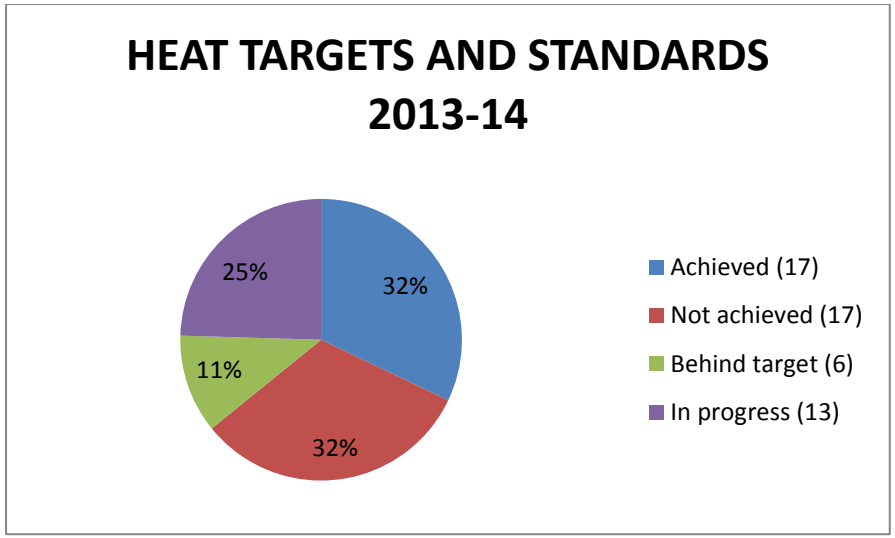
The Board has a well-developed Performance Management Framework in place and uses the balanced scorecard methodology to measure performance against national HEAT targets and local priorities and adult social care services across the year. The scorecard is monitored by the Improvement Committee which then provides an assurance report to the Board.

We are satisfied that appropriate performance management arrangements were in place within NHS Highland for 2013/14 albeit the Board was unable to successfully deliver on all the national and local targets/standards.

Overview of performance targets in 2013/14

The Board receives regular performance reports from the Improvement Committee on progress towards achieving the key performance targets set by the Scottish Government (HEAT targets and standards) and local standards.

The Board's performance against its HEAT targets and standards as reported in the 2013/14 accounts is summarised in the diagram below.



Source – 2013/14 Annual Accounts " At a Glance" pages 23-24

The Board has achieved some of its targets and standards including, child healthy weight interventions, smoking cessation, early access to antenatal services and 4 hour A&E wait. Included in the achieved category are the financial position and cash efficiencies targets, however, as already noted, this was only achieved after receiving brokerage and additional support from The Highland Council this year. NHS Highland's financial performance will continue to be a significant feature of the Improvement Committee's agenda, including the regular review of Raigmore Hospital's three year recovery plan.

A number of targets were not achieved this year and the Improvement Committee has been monitoring progress in the delivery of various access targets, in particular Cancer, 12 week Outpatients and the 9 week admissions waiting time targets, plus the 12 week Treatment Time Guarantee. Performance against each of these had deteriorated through the year and the Improvement Committee has sought regular updates on the plans to improve the position.

Two of the " in progress" measures relate to outpatient unavailability and a further two to admissions waiting list unavailability. This information had not been available for the full year and officers have confirmed that this has been reported to the Improvements Committee since December 2013.

A key focus for the Improvement Committee in 2014/15 will be developing the Adult Social Care measures to ensure they are fit for purpose.

Outlook

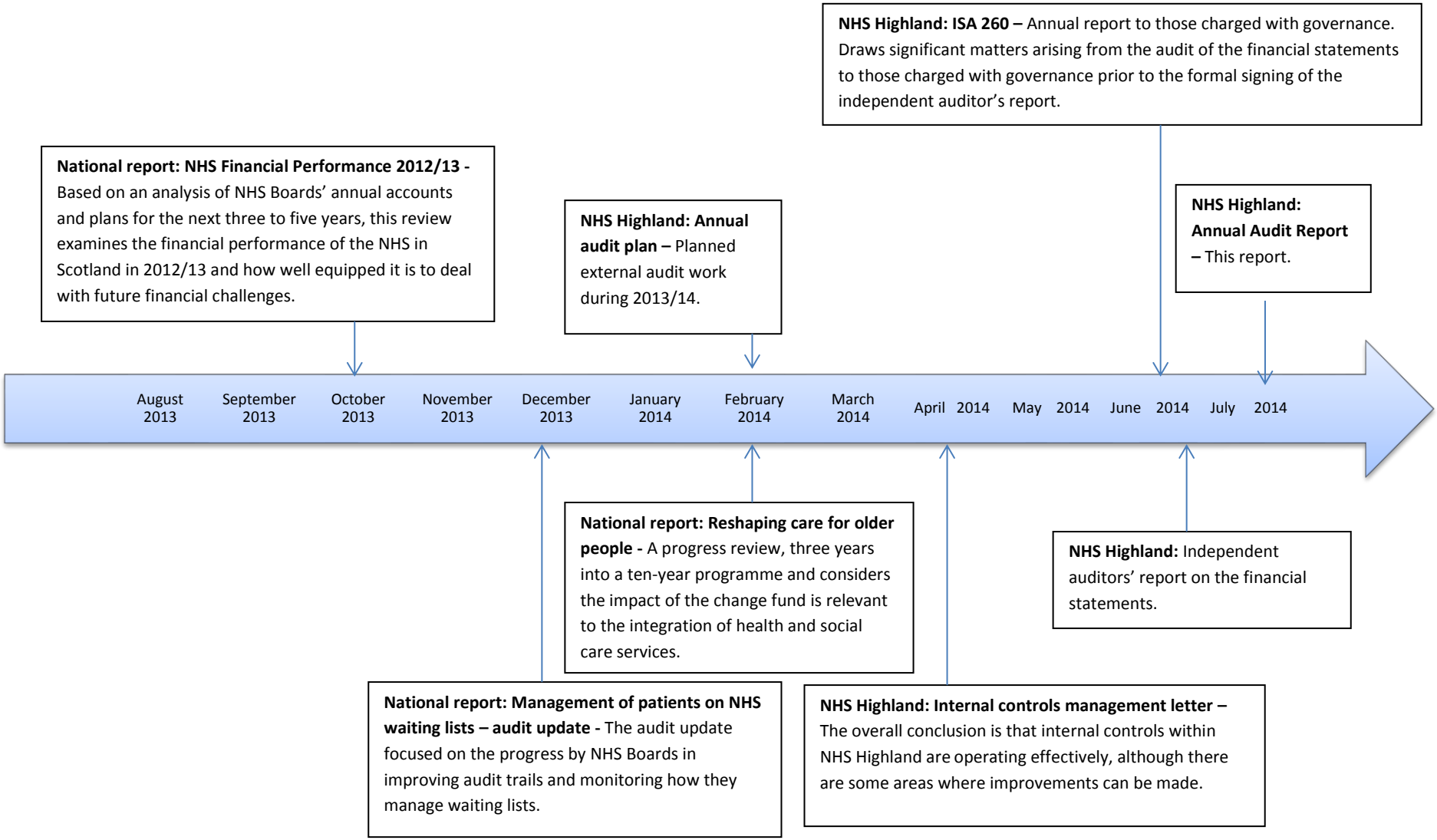
NHS Highland faces unprecedented demand for increased and improved services arising from changing demographics, lifestyles, health inequalities, increasing public expectations, the availability of new drugs, treatments and technologies and the impact of health service specific inflation. As demand, and the consequent cost of healthcare, continues to grow, the Board will struggle to deliver at current funding levels. The scope of what can be done to respond to tough financial pressures is limited: services will need to be transformed to improve quality, while also making them more efficient and sustainable.

As highlighted previously, the financial pressures relating to

integration will further impact on these demand pressures. It is essential therefore that the Board delivers its recurring savings to alleviate some of this pressure.

NHS Highland is facing particular challenges in terms of financial resources and it is difficult to see, in the short term, how the Board will be able to deliver all of its performance targets.

Appendix I –Summary of Audit Scotland reports 2013/14



Appendix II - Significant audit risks

The table below sets out the key audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure
Failure to meet financial targets	The Board regularly review financial monitoring reports and monitoring returns submitted to SGHSCD. Discussions with SGHSCD on the financial difficulties began in December 2013.
	The Board received £2.5 million brokerage from the Scottish Government to ensure financial targets were met.
Capital Investments - service delivery may be impacted if the Board is unable to maintain its estates.	The Board included maintenance costs within their capital budget for 2013/14 to ensure essential maintenance of its estates was undertaken.
	Annual review of 'the state of the estate' report is performed by the Asset Management Group, approved by the Board and submitted to SGHSCD.
Equal pay liability cannot be quantified.	The number of Equal Pay Claims has reduced from 246 in 2012/13 to 165 in 2013/14. While the risk is reducing over time the NHS Central Legal Office (CLO) continue to advise that it is not possible to provide any quantification of Equal Pay Claims
	The Board has included an unquantified contingent liability in its accounts in line with advice from the CLO and continues to maintain links with the SGHSCD and CLO to keep up to date with progress being made in settling Equal Pay Claims.

Audit Risk	Assurance procedure
Integration may not deliver the efficiencies expected and there may be an adverse impact on the quality of service delivery.	The Board secured additional funding from The Highland Council for 2013/14 and the following three years.
	Review of financial position with Improvement Committee and Highland Health and Social Care Committee. Review and challenge by the Informal Strategic Commissioning Group and Strategic Commissioning Group.
Failure to make the required reductions in senior managers.	The Board has reduced the number of senior managers by 13 wte since March 2010 and is over two thirds of the way to meeting its overall target of 18.5 wte by April 2015.
	The Board regularly monitor the position through the Workforce Planning and Development Sub Group which report to the Board through the Staff Governance Committee on a quarterly basis.
Failure to achieve the sickness absence target of 4%	The Board undertake regular audits of long term cases to ensure early and appropriate interventions.
	Long term sickness absence (>90 days) is reviewed by Head of Personnel and Occupational Health Consultant on a monthly basis (can be analysed for location, age, and reason for absence).
	Sickness absence trends increased to 4.9% in 2012/13, largely as a result of 1620 adult social care staff transferring from The Highland Council. The sickness absence rate fell slightly to 4.8% in 2013/14.

Audit Risk	Assurance procedure
The Board is unable to successfully fill vacancies in remote areas which may lead to increased costs from the need to rely on medical locums.	The Board has introduced more robust governance arrangements to monitor the use and costs of medical locums.
	The Board is seeking to mitigate the costs of agency staff by using national contracts or NHS rates where possible, but the high cost of locums was a key factor in the Board's financial position in 2013/14.
Performance targets may not be achieved and this may impact on the delivery of wider clinical priorities.	The Board carry out detailed scrutiny of performance against HEAT targets through reporting to the Improvement Committee.
	The Board has put in place plans to achieve HEAT targets but was unable to deliver on the majority of these during the year.
Consolidation of Endowment Funds is not undertaken in accordance with IAS 27.	The Highland Health Board Endowment Funds were consolidated into NHS Highland's financial statements for the first time in 2013/14 in accordance with IAS 27 and as required by the health accounts manual. The basis of consolidation was merger accounting.
	The external auditors of Highland Health Board Endowment Funds issued a clear audit opinion. The Endowment Funds Accounts were approved by the Board on the 25th June 2014.

Appendix III – Action plan

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
1/10	**Draft Accounts** The unaudited accounts template was provided to us on 6 May 2014, but did not include the endowment funds which required to be consolidated into the Board's accounts. The unaudited consolidated template was received on 12 May 2014, and the narrative sections of the unaudited accounts, including the Operating and Financial Review, Accounting Policies, Remuneration Report and Annual Governance Statement on 20 May 2014. **Risk** The Board's accounts will not be audited by the 30th June deadline if the draft accounts are not provided timeously. **Recommendation** Senior management in the Board's finance team should ensure that a full set of unaudited accounts are provided to audit in accordance with the agreed timetable.	Agreed. This was the first year of consolidation which caused a delay. The timetable for production for 2014/15 will be more detailed and agreed prior to March 2015.	Head of Area Accounting	March 2015

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
2/12	**IAS19 Pension entries** The Board has a pension liability for adult social care staff who remained members of the Highland Council Pension fund on integration. The NHS accounts template does not cater for such entries and the Board had to include reconciliation at Note 24 to show how the appropriate entries are reflected in the accounts. **Risk** The Board's accounts do not clearly reflect its additional pension liability as a member of the Highland Council Pension Fund and therefore do not fully comply with IAS19. **Recommendation** The Board should liaise with both SGHSCD and the Technical Accounting Group to ensure that its pension arrangements are properly reflected in the NHS annual accounts template.	Agreed. The Technical Accounting Group is to be advised that the accounts template needs to be changed to reflect fully the issues of integrating health and social care using the Lead Agency Model.	Head of Area Accounting.	July 2014

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
3/13	**Financial Monitoring** Throughout 2013/14, the Board forecast a year end breakeven position. In-year deficits were reported as being addressed by 'management planned actions', but there were no detailed plans behind these actions, and it was not clear how the Board planned to make these unidentified savings. **Risk** Information provided to the Board is not sufficiently detailed to enable sound decision making. **Recommendation** Detailed plans for the savings required in 2014/15 should be formally documented and monthly finance reports to the Board should sufficiently capture any risks around the achievement of financial targets.	Agreed. The Board has set up a Programme Board to monitor the delivery of key efficiency projects on a weekly basis. This is chaired by the Chief Executive and attended by all Executive Directors and Operational Directors. Once a month the meeting is attended by two non-executive Board members. The key efficiency projects are backed by formal charters and driver diagrams. Monthly finance reports will include a risk assessment for the savings programme.	Director of Finance	On-going

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
4/14, 15 & 23	**Financial Pressures** The financial position and delivery of the cost savings plan for 2014/15 and subsequent years will continue to remain challenging. At the start of 2014/15 the Board had a carry forward of non-recurrent savings of £8 million. The overspend position at Raigmore is a significant financial pressure for the Board as are the pressures in relation to adult social care services. It is anticipated that it will need to seek non recurring support, in addition to the already agreed recurring funding, from the council in future years to help alleviate these pressures (£1.5 million non recurring agreed for 2014/15). **Risk** The required efficiency savings will not be achieved which could have an adverse impact on the quality of service delivery. **Recommendation** The Board should ensure that formal plans are produced covering all of the required savings for 2014/15 onwards.	Agreed. It should be recognised that at this stage formal plans will be high level for future financial years. The Board will agree principles for service delivery in summer 2014 (as part of the Co-production & Improvement Plan) and this will inform the detail of future savings plans. The plans for 2014/15 are already set out in some detail (in the form of charters with supporting driver diagrams). Many of these will have actions and impacts well beyond 2014/15 and these will form the basis of plans for future years.	Director of Finance	On-going

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
5/14	**Budget management procedures – Raigmore**. Raigmore hospital overspent against budget by £9.65 million in 2013/14. Internal Audit raised concerns about poor budget management at the hospital and there is no assurance that these issues are not prevalent across the other operating units. **Risk** The Board is unable to meet financial targets as a result of poor budget monitoring across operational units. **Recommendation** Budget holders should be required to appropriately manage their budgets and be held to account for overspends**.**	Internal audit will review the financial management and budgetary control systems within the other operating units beginning with North & West in autumn 2014/15. In addition, a budget holders training programme is being formulated with initial focus on Raigmore unit and thereafter, rolled out to other operational units if/as required.	Director of Finance	Progress in 2014/15 but in effect this will be ongoing

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
6/15	**Sickness Absence** Although the Board has reduced its sickness absence in 2013/14 to 4.8% it is finding it difficult to achieve the national target of 4%. **Risk** A high sickness absence level will impact on the Board's ability to achieve its financial and non –financial performance targets and could adversely impact on safe and efficient service delivery. **Recommendation** The effectiveness of the measures introduced to reduce absence levels should be assessed to ensure they are appropriate and can deliver the necessary reductions.	Monitoring of sickness absence levels and appropriate interventions within agreed PIN Policies are continuous actions taken by Managers, HR and OHU staff. Sickness absence annual average rates have ranged between 4.43% and 5.03% in the last 5 years. Our evidence also shows that over the same period long term sickness accounts for 65-70% of all sickness absence. As this accounts for around 3% of our total, our efforts are focussed on this group through individual case audit, case conference management of particular cases, rehabilitation support via OHU services and appropriate use of interim redeployment and/or phased returns. We believe this is the correct area of focus.	Director of Human Resources	On-going

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
7/16	**Agency workers** The spending on agency/bank staff increased significantly (82%) in 2013/14. NHS Highland faces continued challenges in recruiting staff in rural areas, in particular consultants, GPs, higher band nurses and pharmacists. Whilst the use of agency/bank staff provides flexibility to the care system and temporary cover for vacancies and staff absence, it is important that controls are in place and that trends and patterns are managed and monitored closely. **Risk** Continued reliance on agency workers to this extent will have a significant impact on the Board's ability to achieve the savings required for longer term sustainability. **Recommendation** The Board should monitor and manage the use of agency staff with a view to reducing their cost.	There is a high level project charter in place for 2014/15 led by the Chief Executive and Medical Director to reduce overall cost attributed to medical locums by 50% (net of vacancy funding). £1.85 million plans are also in place to improve RGH consultant recruitment (being driven nationally by SGHD). There is also an ongoing focus to reduce supplementary staffing (bank agency and overtime) across all staff groups and monitoring and reporting is in place to the Board via finance and the quarterly workforce plan rolling action plan update	Chief Executive	31 March 2015 and ongoing

Action plan point/ page	Issue, risk and recommendation	Management action/ response	Responsible officer	Target date
8/20	**Prevention and Detection of Fraud** Staff who transferred to the Board as a result of integration of adult health and social care had been subject to Highland Council policies in relation to fraud during 2012/13. In 2013/14 these staff had not received any specific training on the Board's fraud policies although they had been made aware of where the policies could be found. **Risk** Staff who transferred from the council are not complying with the Board's policies and procedures in relation to fraud prevention. **Recommendation** The Board should provide training to previous council staff on its fraud policies and procedures.	A rolling programme of fraud awareness is being progressed to all staff including adult social care throughout the NHS Highland area	Head of Area Accounting	Ongoing

Appendix IV – Summary of Financial Pressures