



# **NHS Lothian**

## **2014/15 Annual Audit Report**

**Prepared for the Board of NHS Lothian and the  
Auditor General for Scotland**

**June 2015**

The Auditor General for Scotland appoints external auditors to NHS bodies in Scotland.  
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Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk))

The Auditor General has appointed David McConnell as the external auditor of NHS Lothian for the period 2011/12 to 2015/16.

This report has been prepared for the use of NHS Lothian and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the health board. The information in this report may be used for Audit Scotland's annual overview report on the NHS in Scotland published on its website and presented to the Public Audit Committee of the Scottish Parliament.

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# Key messages

<p>Audit of the financial statements</p>	<ul style="list-style-type: none"> <li>• Unqualified independent auditor's report on the 2014/15 financial statements.</li> </ul>
<p>Financial management and sustainability</p>	<ul style="list-style-type: none"> <li>• All financial targets in 2014/15 were met.</li> <li>• A surplus of £0.239 million was achieved against total Revenue Resource Limit (RRL).</li> <li>• Total savings of £37.9 million achieved (£21.9 million on a recurrent basis).</li> <li>• Financial management is effective and soundly based.</li> </ul>
<p>Governance and transparency</p>	<ul style="list-style-type: none"> <li>• The board has sound and well-established governance arrangements in place.</li> <li>• Systems of internal control operated effectively during 2014/15.</li> <li>• The board has an effective internal audit function and robust anti-fraud arrangements.</li> <li>• The four Lothian draft Health and Social Care integration schemes have been completed and work is underway to meet the strategic plan deadline date of 31 March 2016.</li> </ul>
<p>Best Value</p>	<ul style="list-style-type: none"> <li>• The board has a well developed performance management framework in place.</li> <li>• The board receives regular updates on all aspects of performances and the actions being taken to improve performance.</li> <li>• The board has made progress in addressing some HEAT targets and standards although it has not met delayed discharge and waiting time targets in 2014/15.</li> </ul>
<p>Outlook</p>	<ul style="list-style-type: none"> <li>• The board continues to operate in a funding environment which is subject to sustained pressure to deliver a balanced budget at the same time as having to make major changes to service delivery such as health and social care integration and the Scottish Government's 2020 Vision. Achieving sustainability in the medium term will be challenging and may require investment, innovation and vision to design and deliver the required services.</li> </ul>

# Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of NHS Lothian. The report is divided into sections which reflect our public sector audit model.
2. The management of NHS Lothian 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.
3. Our responsibility, as the external auditor of NHS Lothian, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, summarised at **appendices II and III**, include recommendations for improvements.
6. **Appendix IV** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that NHS Lothian understands its risks and has arrangements in place to manage these risks. The board should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. 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.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

# Audit of the 2014/15 financial statements

<b>Audit opinion</b>	<ul style="list-style-type: none"><li>• We have completed our audit and issued an unqualified opinion that the financial statements of NHS Lothian for 2014/15 give a true and fair view of the state of affairs of the board and the group and of their net operating costs for the year.</li></ul>
<b>Regularity of income and expenditure</b>	<ul style="list-style-type: none"><li>• In our opinion, in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with relevant legislation and guidance.</li></ul>
<b>Other information</b>	<ul style="list-style-type: none"><li>• We review and report on other information published with the financial statements, including the Management Commentary, Governance Statement and Remuneration Report. We have nothing to report in respect of these statements.</li></ul>
<b>Consolidation template</b>	<ul style="list-style-type: none"><li>• The board's consolidation template has been audited to confirm that the figures are consistent with the audited financial statements.</li></ul>

## Submission of financial statements for audit

9. We received the unaudited financial statements on 5 May 2015, in accordance with the agreed timetable, however the governance statement was not available until 28 May 2015 due to delays in the receipt of the required assurances. The working papers were of a good standard and finance staff provided good support to the audit team which assisted the delivery of the audit to deadline.
10. Finance staff have made a number of improvements to the accounts to enhance the overall transparency. This is consistent with the good practice note issued by Audit Scotland in its publication *Improving the quality of NHS annual report and accounts* (December 2014).

## Overview of the scope of the audit of the financial statements

11. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan that was presented to the Audit and Risk Committee on 19 February 2015.
12. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

13. The concept of audit risk is of central importance to our audit approach. 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 audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.
14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

## Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of the financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).
16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

17. We summarised our approach to materiality in our Annual Audit Plan. On receipt of the financial statements, we revised our planning materiality for 2014/15 to £17.9 million (1% of gross expenditure). Performance materiality was set at £12.5 million to ensure that uncorrected and undetected audit differences do not exceed our planning materiality level. We report all misstatements greater than £0.1 million.

## Evaluation of misstatements

18. No misstatements were identified during the audit which exceeded our materiality threshold.
19. A number of presentational and monetary adjustments were identified during the course of our audit and discussed with finance officers. The overall effect of the adjustments made to the financial statements is to decrease net operating costs by £0.492 million. Net assets as recorded in the consolidated balance sheet have decreased by £0.458 million.
20. There were also a small number of misstatements that finance officers decided not to adjust in the financial statements. If these had been adjusted for they would have increased net operating costs by £0.019 million with a similar reduction in the net asset position. The overall impact would have been that the total revenue resource outturn would have reduced from £0.239 million to £0.220 million.

21. We requested that all errors be corrected, although the final decision on this matter rests with those charged with governance taking into account advice from officers.

## Significant findings from the audit

22. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
  - Significant difficulties encountered during the audit.
  - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
  - Written representations requested by the auditor.
  - Other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.
23. The following table contains a summary of the significant findings that, in our view, require to be communicated to you in accordance with ISA 260.



## Significant findings from the audit

Issue	Resolution
<p><b>Income recognition:</b> The accounts contain £10.350 million income relating to the ongoing rates review that is expected to be finalised during 2015. The recognition of the income was based on the advice of the board's advisers who are involved in negotiating the settlement.</p>	<p>Given the stage of the negotiation and the information from the advisers on the status of the review we agreed that the £10.350 million income should be recognised in the 2014/15 accounts.</p>
<p><b>Endowment realised gains:</b> The unaudited accounts did not contain the realised gains arising in year from the disposal of endowment assets. This occurred as the endowment fund accounts are prepared under a different accounting framework which does not require this treatment.</p>	<p>The accounts have been adjusted to recognise the endowment fund realised gains in year of £0.474 million. An adjustment has been made in the resource outturn statement to ensure that the additional income recognised does not impact on the revenue resource outturn for the year.</p>
<p><b>Revaluation:</b> Audit testing identified an issue which resulted in a duplicate ledger entry for an impairment reversal of £0.458 million.</p>	<p>The accounts have been adjusted to remove the duplicate entry. The impact of this adjustment was to reduce net assets by £0.458 million.</p>
<p><b>Pay, terms and conditions accrual:</b> Updated information on the progress of negotiations of pay terms and conditions of staff transferred out from NHS Lothian highlighted that the two tier working accrual in the unaudited accounts was overstated by £0.599 million.</p>	<p>Officers have decided not to adjust the accounts. The impact of this adjustment would be to decrease net operating costs by £0.599 million with a similar impact on the resource outturn for the year.</p>

Issue	Resolution
<p><b>Depreciation:</b> Audit testing identified two assets where depreciation had not been charged for 2014/15. This was due to incorrect information on when the asset came into operational use. The depreciation charge for the year should have been £0.043 million.</p>	<p>Officers have decided not to adjust the accounts. The impact of this adjustment would be to change the achievement of the non core revenue resource limit into an overspend of £0.043 million, however this can be met by the underspend recorded against the core revenue resource limit.</p>
<p><b>Prescribing under accrual:</b> On 2<sup>nd</sup> June finance officers received the actual detail for GP prescribing from Practitioner Services Division which highlighted that the accrual in the unaudited accounts was understated by £0.619 million due to adverse volume and price movements from the original estimate.</p>	<p>Officers have decided not to adjust the accounts. The impact of this adjustment would be to increase net operating costs by £0.619 million with a similar impact on the resource outturn for the year.</p>
<p><b>Clinical Negligence and Other Risks Indemnity Scheme (CNORIS) provision:</b> A revised approach to the accounting for CNORIS was introduced in 2014/15 which required the establishment of a new provision.</p>	<p>The board correctly processed and disclosed a prior year adjustment in the unaudited financial statements.</p>
<p><b>Equal Pay:</b> In previous years, we commented that the board, on advice from the Central Legal Office (CLO), was not able to provide any financial quantification of equal pay claims. There have been significant developments in 2014/15 and the Director for Health Finance and Information has advised that equal pay claims should now be included as a provision in the accounts of NHS boards.</p>	<p>The provisions note in the accounts includes wording agreed with Audit Scotland, namely “other provisions include an amount of £0.088 million in respect of the board’s estimated liability arising from equal pay claims”.</p>

## Future accounting and auditing developments

### *Revisions to the financial reporting manual*

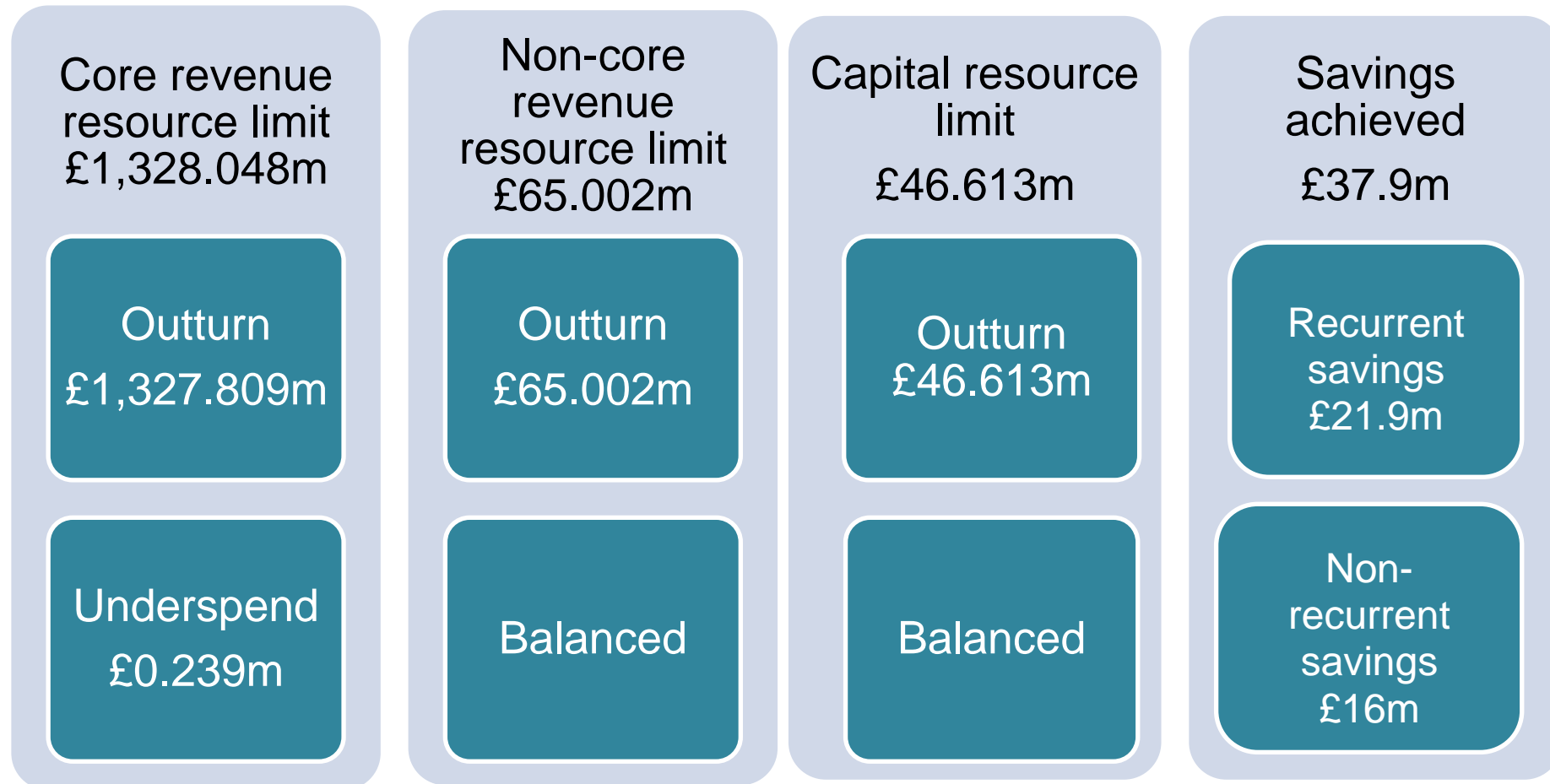
24. The accounts of the board are prepared in accordance with the Government Financial Reporting Manual (FReM). Two significant revisions will apply from 2015/16 as detailed below.
25. **IFRS 13 Fair value measurement:** Although the measurement requirements for operational property, plant and equipment will not change, enhanced valuation disclosures will be required. The 2015/16 FReM will also require surplus assets to be measured at fair value in accordance with IFRS 13.
26. **Restructuring of the annual report:** The 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:
- a performance report which will give a fair, balanced and understandable analysis of the board's performance and will include an overview section and a performance analysis section.
  - an accountability report incorporating the following three main sections:

- corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
- remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
- parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report.

### *Health and Social Care Integration*

27. Integrated Joint Boards (IJBs) will be accountable for overseeing the provision of functions within the scope of health and social care integration on, or before, 1 April 2016.
28. IJBs will be required to produce financial statements in compliance with the Code of Practice on Local Authority Accounting in the UK.
29. The impact of health and social care integration is further considered in the 'financial management and sustainability' and 'governance and transparency' sections of the report.

# Financial management and sustainability



## Financial management

30. In this section we comment on NHS Lothian's financial outcomes and assess the board's financial management arrangements.
31. Budget funding is agreed with the Scottish Government Health and Social Care Directorate (SGHSCD). It is a statutory requirement for the board to ensure expenditure is within the Revenue Resource Limit (RRL) and Capital Resource Limit (CRL) set by the SGHSCD. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

## Financial outcomes

32. Health boards are required to work within the resource limits and cash requirements set by the SGHSCD. The board's final RRL (£1,393.050 million) and CRL (£46.613 million) were agreed with the SGHSCD on 29 April 2015.
33. The board achieved its financial targets (total RRL and CRL) in 2014/15. The actual out-turn position was a cumulative surplus of £0.239 million against a budgeted 2014/15 break-position. As recently as November 2014 the board had been predicting an overspend of £9.4 million due to additional cost pressures. The improved year-end position was due largely to a back-dated rates rebate which contributed £10.35 million of the LRP target.
34. The board did not achieve its 2014/15 LRP efficiency savings target of £39.4 million through recurrent savings. In 2014/15 efficiency savings of £21.9 million were delivered and the shortfall of £17.5

million was met from non-recurrent savings (£16 million) and an underspend against core expenditure. Reliance on non-recurrent savings puts pressure on future years' budgets and wherever practical all savings should be achieved on a recurrent basis to help secure long term financial sustainability.

## Capital expenditure 2014/15

35. The board remained within its Capital Resource Limit (£46.613 million) which included £17.815 million ODEL (spending outside the departmental expenditure limit) funding for new PFI assets that are currently under construction. It fully utilised its capital allocation. This was mainly spent on rolling programmes, including backlog maintenance and medical equipment; and on the reprovisioning of the Royal Hospital for Sick Children/Department for Clinical Neuroscience.

## Financial management arrangements

36. As auditors, we need to consider whether health bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
  - the Director of Finance has sufficient status to be able to deliver good financial management
  - standing financial instructions and standing orders are comprehensive, current and promoted within the board
  - reports monitoring performance against budgets are accurate and provided regularly to budget holders

- monitoring reports do not just contain financial data but are linked to information about performance
  - members provide a good level of challenge and question budget holders on significant variances.
37. We reviewed the board's standing financial instructions and standing orders and concluded that they are comprehensive and current.
38. Financial monitoring reports are submitted to all meetings of the Finance and Resources Committee and the Board. Reports are comprehensive and contain service performance information at board level and business unit level. More detailed reports, including monthly financial monitoring are provided to budget holders to enable corrective action to be identified and taken.
39. As auditors we attend a number of board and committee meetings each year. Members provide a good level of challenge and question budget holders on significant variances and service performance issues.

### Conclusion on financial management

40. We have concluded that the board has effective financial management arrangements in place that support the review and scrutiny of financial performance.

### Financial sustainability

41. Financial sustainability is concerned with whether the board has the capacity to meet the current and future healthcare needs of the communities it serves. In assessing financial sustainability we consider the board's financial performance, financial planning, capital programmes and workforce management.

### Financial planning

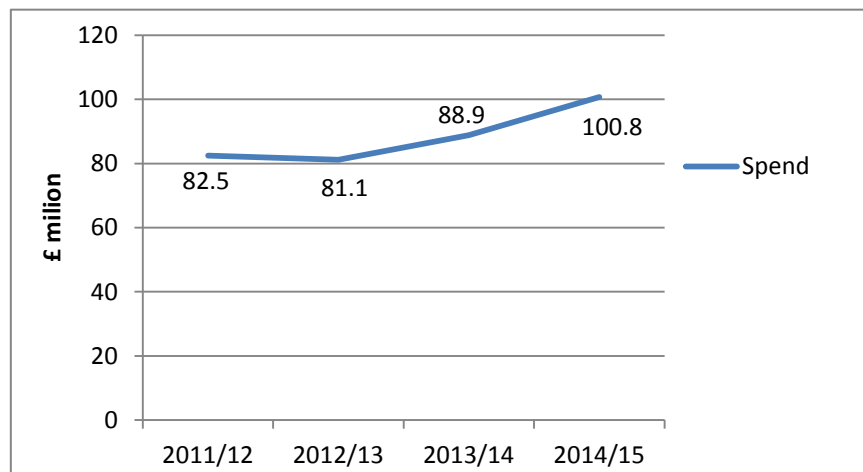
42. The board is required to prepare a Local Delivery Plan (LDP) each year which aligns strategic priorities with financial plans, workforce plans and asset plans. The LDP recognises that the vast majority of resources are already committed on a recurring basis before the start of each year and therefore there is limited flexibility available to the board.
43. The financial plan is a key element of the LDP and shows that, for 2015/16, the board has identified a recurring gap of £14 million that must be offset by non recurring resources to enable them to achieve a balanced financial position. NHS Lothian are receiving a basic funding uplift for 2015/6 of 2.7% with the majority of this funding required to cover the costs associated with the integration fund, requirements for new drugs and delayed discharges.
44. Total savings of £30 million are required for 2015/16 (and in each of the subsequent four years) of which £20 million is planned on a recurrent basis with the balance (£10 million) coming from non-recurrent sources. The achievement of these savings represents a significant challenge for the board.

45. Efficiency savings of £30.3 million have now been identified for 2015/16, however the board recognises that a significant proportion, more than 40%, of the planned efficiencies are high risk and that the delivery of these may not be achievable. Detailed plans are being prepared and there is an ongoing challenge process to review the likelihood of delivery and reassess the level of saving that will be achieved.

**Refer to Action Plan No. 1**

46. The plan also recognises the significant cost pressures facing the board going forward notably delayed discharges and the increasing costs of acute drugs. The following exhibit shows the increase in spend on acute drugs since 2011/12.

**Exhibit 1: Spend on acute drugs**



47. The exhibit demonstrates the significant cost pressure associated with acute drugs where total spend has increased by £18.3 million (22.2%) since 2011/12. The 2015/16 financial plan includes 15.2% uplift for this area of spend against a funding uplift of 1.8%. These cost pressures exacerbate an already challenging position that exists due to the rising demand for services particularly among the elderly. The financial plan forecasts a deficit position for 2016/17 (£8 million) and 2017/18 (£6 million) before the board returns to surplus in 2018/19 and 2019/20. There are significant assumptions involved in preparing these long term plans including the annual funding uplift (1.8%) and the savings that can be achieved.

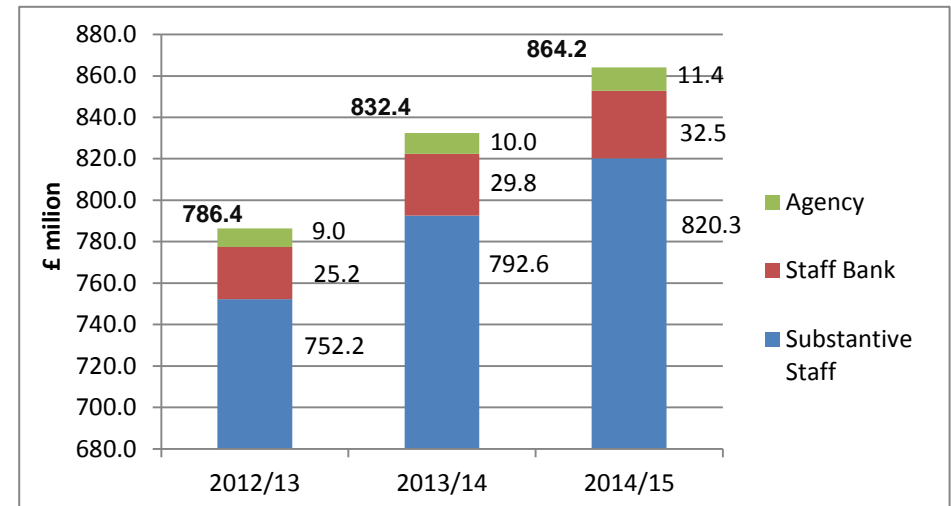
48. Savings will therefore play a significant part in maintaining financial balance over the 5-year period. The financial plan estimates that efficiency savings of 3-5% will be required on a recurring basis in future years. A large amount of savings have already been achieved in previous years and it will become progressively more challenging year on year to identify further areas of savings.

49. The board has also considered the creation of the four Lothian IJBs which will have a number of implications for the board's financial planning going forward. The financial planning for delegated functions will be undertaken by the IJB, not the board, therefore planning cycles will need to be harmonised to ensure effective arrangements are in place. IJB's sharing board resources (e.g. delegated acute services) are expected to work together. However if IJBs were to adopt different positions to overall acute services (managed by the board) then financial planning would become more challenging.

## Workforce Management

50. Workforce planning is integral to the board's strategic planning process and is a key element of the LDP. Staff resourcing is an important factor in the board's capacity to provide patient care.
51. The population served by NHS Lothian is predicted to grow faster than any other area in Scotland over the next 25 years. The largest area of growth will be among those over 60 and the demands of an ageing population coupled with treatment time guarantees will require an increase in capacity within its workforce.
52. Spending on nursing and support staff costs in 2014/15 showed a £6.408 million overspend against the annual budget. This overspend, driven largely by supplementary staff costs, was offset by underspends in other pay areas (net overspend: £0.437 million).
53. In 2011/12 there was a significant reduction in the size of the workforce, however in recent years the board has had to increase the staffing numbers in order to deliver the required services (18,569 average whole time equivalent in 2011/12 has increased to 20,600 in 2014/15). Despite this increase in workforce the board has also seen an increase in agency staff numbers in order to support service delivery.
54. Exhibit 2 shows the workforce, staff bank and agency costs since 2012/13 based on management accounts. This shows an overall increase of £87.5 million (10.7%) since 2012/13 with spend increasing in all 3 categories.

**Exhibit 2: Workforce spend**



55. We recognise that the use of bank, agency and locum staff, provides flexibility to cover for vacancies and staff absence. However, continued reliance on such staff could have an impact on the board's plans to achieve the savings required for longer term sustainability.
56. The 2014/15 NHS Lothian Workforce plan highlights the large, and increasing, proportion of the workforce that are nearing retirement age. This observation is particularly pronounced amongst nursing staff although there has been a good level of recruitment which partly offsets this risk. The board is addressing this issue through a range of initiatives including streamlining the recruitment process and close partnership working with education providers.



57. One area where this is particularly evident is within community nursing where nearly half the workforce are now nearing retirement age. Sustainable delivery of this service will be challenging with problems recruiting, an increase in the population of children (0-15 years) predicted and the increased requirement for health visitors resulting from the Children and Young People (Scotland) Act 2014. Additional funding was targeted at Health Visitor training during 2014/15 to help alleviate this pressure.
58. As with other health boards, NHS Lothian is struggling to achieve the national performance standard for sickness absence (4%). At 4.71% the board is below the Scottish average of 5% however the rate has been steadily increasing since 2011/12. The board is committed to managing sickness absence downwards through a range of measures including increased support for line managers and the application of a robust and consistent process for managing poor attendance.

### Cost of pension provision

59. The UK Government has been pursuing a programme of reform of public service pensions across the UK, including in Scotland. As a result, new Career Average public service pension schemes are being created from 1 April 2015.
60. A revaluation of the pension scheme was carried out using pension scheme data as at 31 March 2012. This new valuation is being used to set a new employer contribution rate payable from 1 April 2015 to 31 March 2019. The new rate will be 14.9% of pensionable pay, compared to the rate of 13.5% which has been paid since 1 April 2009. The impact on employer's costs in 2015/16 has been quantified in NHS Lothian at approximately £8.698 million recurring and has been reflected in the board's 2015/16 financial plan.
61. The valuation also establishes a new employer cap that will apply from the next valuation in 2017. This is required by the Public Service Pensions Act and is designed to control future changes in cost above a certain threshold by providing backstop protection by sharing the risks with scheme members. The employer contribution cost cap for the NHS pension scheme for Scotland is 11.5% of pensionable pay.

### Public Finance Initiative (PFI) / Public Private Partnerships (PPP) costs

62. NHS Lothian has seven PFI/PP projects which include the Royal Infirmary of Edinburgh and Midlothian Community Hospital and are disclosed in note 23 of the accounts. The capital costs of these projects are included in the balance sheet with a combined value of £222.920 million. The associated recurrent cost of these schemes is £54.320 million with a total future commitment recorded in the balance sheet of £599.949 million.
63. During 2014/15 NHS Lothian reached financial close on two further projects, the Royal Edinburgh Hospital re-provision project and the Royal Hospital for Sick Children / Department of Clinical Neurosciences re-provision project. These are included in the accounts as assets under construction with a value of £17.815 million. The total cost of these projects is £191.126 million.

64. The Royal Hospital for Sick Children / Department of Clinical Neurosciences is due to be commissioned in September 2017.

## Conclusion on financial sustainability

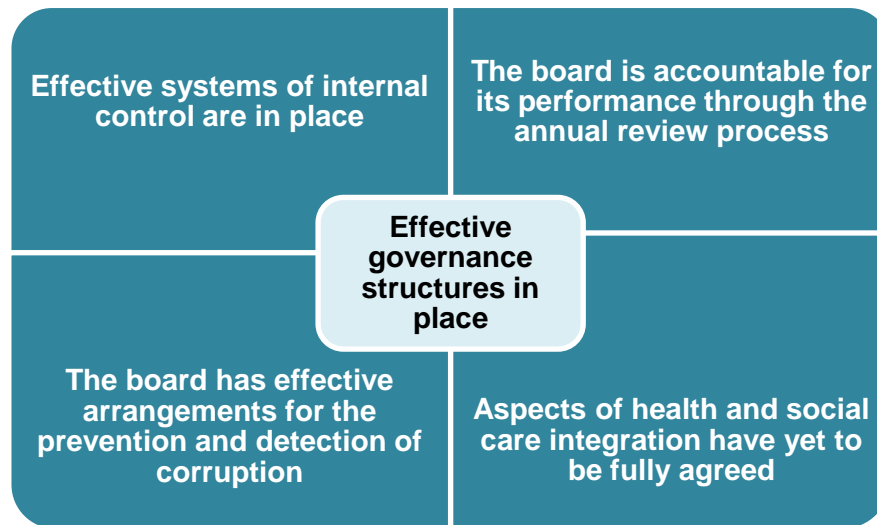
65. Overall, we have concluded that the board's financial position is currently stable, however there are significant challenges in the foreseeable future in relation to the identification of recurring savings and ensuring that the board remains within its funding limits.

## Outlook

66. The board has prepared a financial plan showing how balance could be achieved for 2015/16. There are challenging times ahead with a deficit position predicted for 2016/17 and 2017/18 before the board is returned to surplus in 2018/19 and 2019/20. Delivery of the five year plan is dependent on significant efficiency savings each year to bridge the gap between available funding from current sources and the cost of services. Also, the board will continue to operate in a funding environment which is subject to sustained pressure to deliver a balanced budget at the same time as having to make major changes to service delivery such as health and social care integration and the Scottish Government's 2020 Vision.
67. The level of flexibility within expenditure budgets is considerably reduced by the release of cost savings in previous years and this makes it more challenging for the board to deliver balanced budgets in future.

68. The board is also faced with significant challenges arising from increases to its cost base including the increased employer contribution rates from pension reform (£8.698 million) and 2016/17 changes in national insurance (£13.7 million). In effect, the board will have to meet this recurrent expenditure of £22.398 million per annum without any additional funding from the Scottish Government. Overall, the challenges of remaining within budget while delivering against the board's service requirements will remain substantial over the coming years.

# Governance and transparency



- 69. The board and Accountable Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of NHS Lothian and for monitoring the adequacy of these arrangements.
- 70. NHS Lothian is managed by a board of Executive and Non-Executive Directors and is accountable to the Scottish Government through the Cabinet Secretary for Health and Wellbeing. The board's Chair and Non-Executives are appointed by the Cabinet Secretary based on their skills and expertise and ability to contribute effectively to local strategic decision making processes.

- 71. The board is responsible for the strategic leadership and governance of NHS Lothian. It is supported in this role by a number of standing committees as illustrated below:



- 72. The standing committees meet on a regular basis throughout the year to consider relevant matters. We concluded that the board has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

## Transparency

73. We considered how NHS Lothian accounts and reports transparently on their resources. The financial statements clearly include a reconciliation between expenditure and the outturn against budget. The financial statements also include a review of financial results and performance during the year.
74. Local residents should be able to hold the board to account for the services it provides. Transparency means that residents have access to understandable, relevant and timely information about how the board is taking decisions and how it is using its resources.
75. The performance of all NHS boards is subject to an annual review process to encourage dialogue and accountability between local communities and their health boards. The annual review for NHS Lothian was held on the 24 November 2014 and was attended by a board team led by the Chairman. There was also an open session where members of the public could ask questions.
76. Members of the public can also attend meetings of the board and have ready access to board papers on the internet. The board papers provide comprehensive information on all aspects of performance including waiting times and access targets and measures being taken to address them.
77. NHS Lothian's website includes corporate plans, annual reports and minutes of all board meetings. The minutes record declarations of interest and the register of interests is also easily available from the website.

78. Overall we concluded that the board is open and transparent. It is appropriate that some committees (e.g. staff governance and healthcare governance) are held in private because of the confidential and sensitive nature of their business.

## Internal control

79. As part of our audit we reviewed the high level controls in a number of systems fundamental to the preparation of the financial statements. Our objective was to obtain sufficient audit evidence to support our opinion on the financial statements.
80. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the board's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
81. We reported our findings to the Audit and Risk Committee on 20 April 2015.

## Internal audit

82. Internal audit provides the board and Accountable Officer with independent assurance on the board's overall risk management, internal control and corporate governance processes. 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. To avoid duplication, we place reliance on internal audit work where possible.

83. Our review of internal audit concluded that the internal audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.
84. The internal audit plan for 2014/15 is materially complete. We have been able to rely on internal audit's work on NHS waiting times arrangements – sampling and checking; and the Datix system for our wider code responsibilities.

## ICT audit

85. ICT is a key area of control because it underpins all systems used by the board. As part of our planning process we carried out a high level review of ICT covering a number of areas. Overall, we concluded that the board's ICT arrangements are satisfactory and we are not aware of any specific issues that require to be brought to the attention of members.

## Arrangements for the prevention and detection of fraud

86. We assessed the board's arrangements for the prevention and detection of fraud during the planning phase of our audit. This involved reviewing policies and procedures in a number of areas including whistleblowing and liaison with Counter Fraud Services (CFS). The internal audit manager also works closely in partnership with CFS to promote anti-fraud activity and to advise members of current investigations within the NHS in Scotland.

87. We concluded that the board has put in place effective arrangements for the prevention and detection of fraud.

## National Fraud Initiative in Scotland

88. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error.
89. Auditors are required to assess the arrangements that bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself.
90. The National Fraud Initiative has a high profile within the board with data matches investigated and findings regularly reported to the Audit Committee. The 2014/15 exercise is currently underway. No frauds have been identified at this stage and there are no issues of concern that we require to include in this report.

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

91. The board has in place a range of activities designed to maintain standards of conduct including Codes of Conduct for officers and members. Also, there are established procedures for preventing and detecting corruption including annual reviews of Standing Financial Instructions and Standing Orders.

92. Based on our review of the evidence we concluded that the board has appropriate arrangements in place for the prevention and detection of corruption and we are not aware of any specific issues that we need to record in this report.

## Freedom of Information (FOI) requests

93. The board processed 60% of FOI requests within the statutory timescales. There would appear to be valid reasons why some FOI requests were not processed within these timescale, including the complexity of the request. We have no significant concerns about the procedures followed by the board in processing FOI requests.

## Vale of Leven Inquiry

94. The Vale of Leven Hospital Inquiry Report into the circumstances contributing to the high occurrence of *C.difficile* at the Vale of Leven Hospital was published in November 2014. Following publication of the report health boards were required to carry out a self-assessment of progress against the recommendations directed at health boards.

95. In NHS Lothian, work is ongoing against the recommendations noted in the Vale of Leven enquiry with most either fully or partially implemented. The board continues to struggle to meet staphylococcus aureus bacteraemia (SAB) and *Clostridium difficile* Infection (CDI) HEAT targets. They are currently developing a recovery plan which includes recommendations from the Vale of Leven inquiry and the Healthcare Environment Inspection (HEI).

96. The board is actively working to improve performance including working in partnership with NHS Education for Scotland and community nursing teams around wound care, tissue viability and infection prevention and control.

97. Overall, we concluded that the board are taking steps to help reduce healthcare associated infection risk to patients.

## Health and Social Care Integration

98. The Public Bodies (Joint Working) (Scotland) Act received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland. It is one of the most significant public sector reforms of recent years and requires detailed planning to ensure the statutory implementation date of 1 April 2016 is achieved.

99. The board and the four Edinburgh and Lothian councils have agreed to adopt the Body Corporate model for the provision of integrated health and social care across the Lothians. This will result in the delegation of functions to four newly created legal entities. These Integration Joint Boards (IJB) will be responsible for overseeing the provision of services.

100. The four Lothian draft integration schemes were approved by the board on 4 March 2015 prior to approval by council partners and submission to the Scottish Government by the deadline of 31 March 2015 for review and approval. The aim is for the final integration schemes to be approved by the end of June 2015.

- 101.** There are plans in place for the appointment of the Chief Operating Officers and Chief Financial Officers for the IJBs along with the development of budgets and key governance documents such as standing orders. The Chief Operating Officers will have a crucial role in terms of project management and ensuring completion of the strategic plan by the 31 March 2016 deadline.
- 102.** At this stage of development, there remains a risk that health and social care arrangements may not be fully developed by the statutory deadline date of 1 April 2016.

*Refer to Action Plan No. 2*

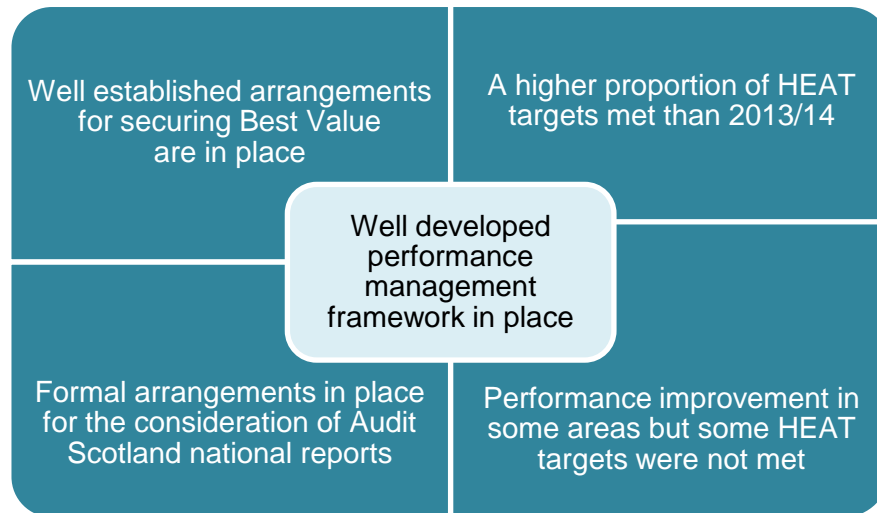
## 2020 Vision

- 103.** The Scottish Government's vision is that by 2020 everyone is able to live longer, healthier lives at home, or in a homely setting. The board has incorporated the 2020 vision into its strategic plan – 'Our Health, Our Care, Our Future 2014-2024'. The plan outlines a range of proposals to help them achieve the 2020 vision such as the need to improve the quality of care, to improve the health of the population and to provide better value and financial sustainability.
- 104.** Health and social care integration is also a key part of the Scottish Government's strategy to enable people to live healthy lives in a community setting. This has its own particular challenges as outlined above.
- 105.** We have concluded that the board is proactive in planning to ensure that the population in the Lothian area are able to live longer, healthier lives at home. However, significant challenges remain not least the need to establish effective partnership arrangements within the Lothian area to take forward health and social care integration.

## Outlook

- 106.** Changes in Scotland's population mean that demands for health and social care will increase significantly over the next 20 years, at the same time that budgets are tightening. Increasing demand is already putting pressure on services. NHS boards need to better understand their demand, capacity and how patients move through the complex health and social care system so that they can match their capacity with current and future needs.
- 107.** NHS Lothian has developed a strategic plan which sets out how it plans to deliver healthcare over the next decade. This is particularly relevant in the context of changing demography and increasing demand. It aims to ensure that services are provided in a way that provides sustainable care for the future and meet the Scottish Government's 2020 Vision.
- 108.** Health and social care integration is also an important element in supporting the delivery of the 2020 Vision. 2015/16 is a transitional year for health and social care integration. A lot of work still has to be done to ensure that the board and its council partners are well placed to successfully deliver on this important strand of the Scottish Government's reform agenda.

# Best Value



109. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value in the use of resources.

## Arrangements for securing Best Value

110. Best Value arrangements are part of business as usual within the board. They are embedded within its planning processes, governance arrangements and its performance management and quality improvement frameworks. The board is committed to the principles of Best Value and continuous improvement and this is evidenced through the LDP, performance reports and committee papers.

111. In addition there are arrangements in place for the Audit and Risk Committee to receive assurance from the Accountable Officer on the board's commitment to Best Value via the Annual Corporate Governance Statement.
112. During the year we assessed the board's People Management arrangements using an Audit Scotland Best Value toolkit. The board achieved a positive overall rating of 'better practice' with staff development highlighted as an area of particular strength. The board also used the Audit Scotland Risk Management toolkit to undertake a self-assessment exercise. The Risk Management Steering Group have used the findings of this review to develop an action plan.
113. Overall, we have concluded that the board has well-developed arrangements for securing Best Value and continuous improvement.

## Performance management

114. The performance of NHS Lothian is monitored by the Scottish Government against a number of HEAT targets and standards which support the delivery of the Scottish Government's national performance framework. These targets and their trajectories are set out in the board's 2014/15 LDP.
115. Performance against HEAT targets and standards is presented to each meeting of the board. These performance reports are accompanied by a narrative providing commentary on performance and setting out actions being taken to support the achievement of the HEAT targets and standards. Furthermore, performance is

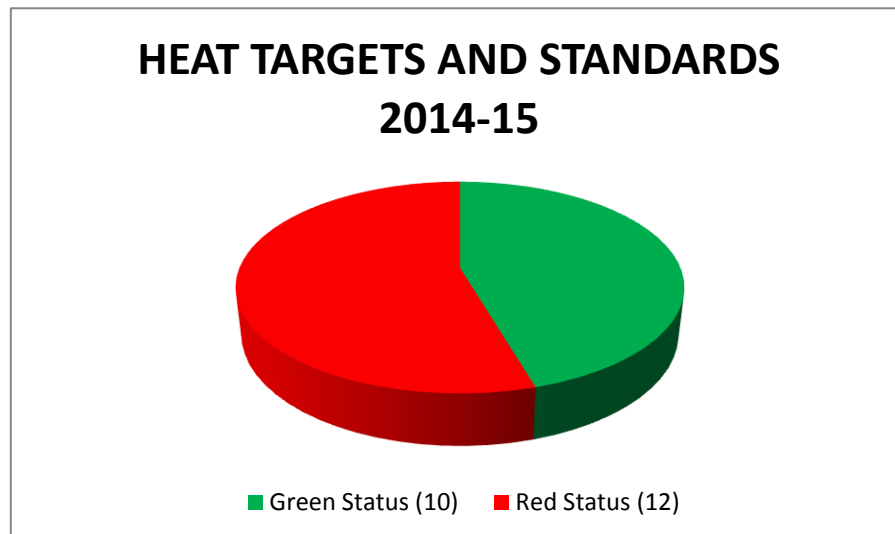


monitored by the Corporate Management Team and discussed at the Annual Review meeting held between the Scottish Government and the board.

116. We concluded that the board had a well established performance management framework in place during 2014/15. This was supported by good performance monitoring.

## Overview of performance targets in 2014/15

117. The board's performance against its 22 HEAT targets and standards as reported in the 2014/15 annual accounts, and based on the most up to date data available regarding the position at the end of March 2015, is summarised in the diagram below.



118. Of the 22 indicators, ten were categorised as green and 12 red, where:
- green means meeting the overall target
  - red means not meeting the overall target
119. Those HEAT standards and targets currently being met (green status) by the board include 48 hour access to the GP practice team, IVF treatment within 12 months, access to antenatal care and treatment of patients with suspicion of cancer within 62 days.
120. The board has again been unable to meet the 28 day delayed discharge target in 2014/15. The position at 15 March 2015 was 57 delays over 28 days and 84 delays over 14 days. From April 2015 the target period has reduced from 28 days to 14 days which will exacerbate the problems of delivering this target. The Lothian Health and Social Care Partnerships have been provided with additional funding from Scottish Government to support delivery of this target.
121. The board has not met the 4 hour accident and emergency waiting times target for 95% of patients and the reported figures for February 2015 (91.6%) had deteriorated from the equivalent figures reported for February 2014 (92.4%). Since then performance has improved and position reported in May 2015 is 94%. However, from April 2015 the target has been increased to 98% of patients which will be extremely challenging for the board.
122. The board has had historic difficulties in achieving waiting list targets. In 2012/13 they received £10 million brokerage from the

Scottish Government to address waiting times issues and this has since been repaid. The 18 week referral to treatment target for 90% of patients remains challenging for the board and was not met in 2014/15, with 85.6% of patients treated within 18 weeks in February 2015.

123. Other targets not achieved (red status) include staff sickness absence rates, hospital acquired infection rates and faster access to child and adolescent mental health services.

*Refer to Action Plan No. 3*

## National performance audit reports

124. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which are of direct interest to the board. These are outlined in **appendix III**.
125. As reported in previous years, NHS Lothian has processes in place to ensure that all national performance reports and their impact on the board are considered by the Audit and Risk Committee and other governance committees, as appropriate.
126. From our attendance at Audit and Risk Committees we concluded that the arrangements for considering national performance audit reports are consistent with good practice.

## Equalities

127. The Equality Act 2010 introduced a new public sector 'general duty' which encourages equality to be mainstreamed into public bodies' core work. The Act requires that by no later than 30 April 2015 and every two years thereafter, public bodies must publish a report on the progress made to achieve the quality of outcomes it has set.
128. The board approved 'NHS Lothian Rights and Outcomes 2013-17' in March 2013. The report is accessible on the board's website and contains links to other publications and source legislation.

## Outlook

129. Audit Scotland in its annual overview of the NHS in Scotland highlighted that there are increasing signs of pressure on NHS boards' ability to meet demanding performance targets. The strong focus, particularly in relation waiting times targets, may not be sustainable when combined with the additional pressures of increasing demand related to demographic changes and the financial constraints in place.
130. The effort that NHS boards are putting in to meeting challenging financial and performance targets each year makes it more difficult for them to focus on long-term planning required to achieve the 2020 Vision.

# Appendix I – Significant audit risks

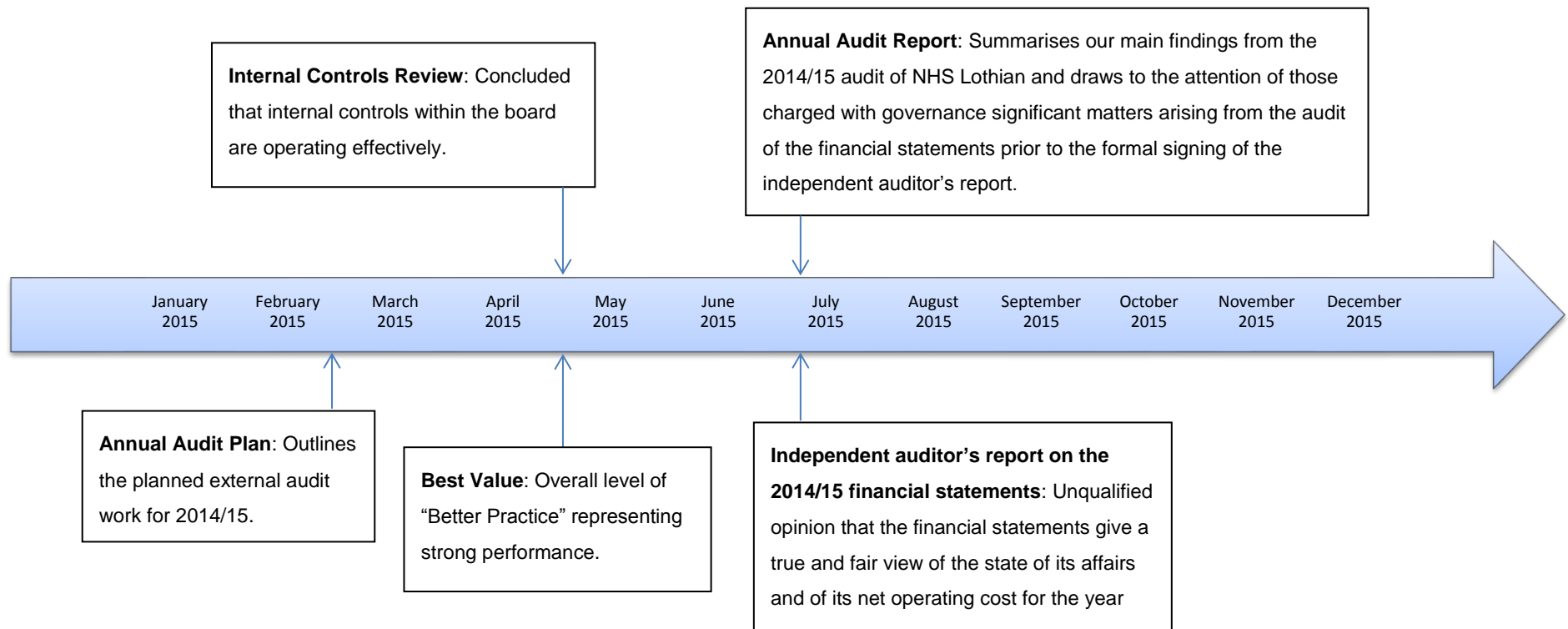
The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
<b>Risk of material misstatement</b>		
<p><b>Income</b> NHS Lothian receives a significant amount of income in addition to Scottish Government funding.</p> <p><b>Risk</b> The extent and complexity of income means there is an inherent risk of fraud in accordance with ISA240.</p>	<ul style="list-style-type: none"> <li>Analytical procedures on income streams.</li> <li>Detailed testing of revenue transactions focusing on the areas of greatest risk.</li> </ul>	<p>We undertook detailed testing of income streams.</p> <p>No frauds were identified.</p>
<p><b>Risk of management override of control</b> ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit.</p> <p><b>Risk</b> Management may override controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> <li>Detailed testing of journal entries.</li> <li>Review of accounting estimates.</li> <li>Focused testing of accruals and prepayments.</li> <li>Evaluation of significant transactions that are outside the normal course of business.</li> </ul>	<p>We undertook detailed testing of journal entries, accruals and prepayments. We also reviewed accounting estimates and transactions for appropriateness.</p> <p>We did not identify any incidents of management override of controls.</p>

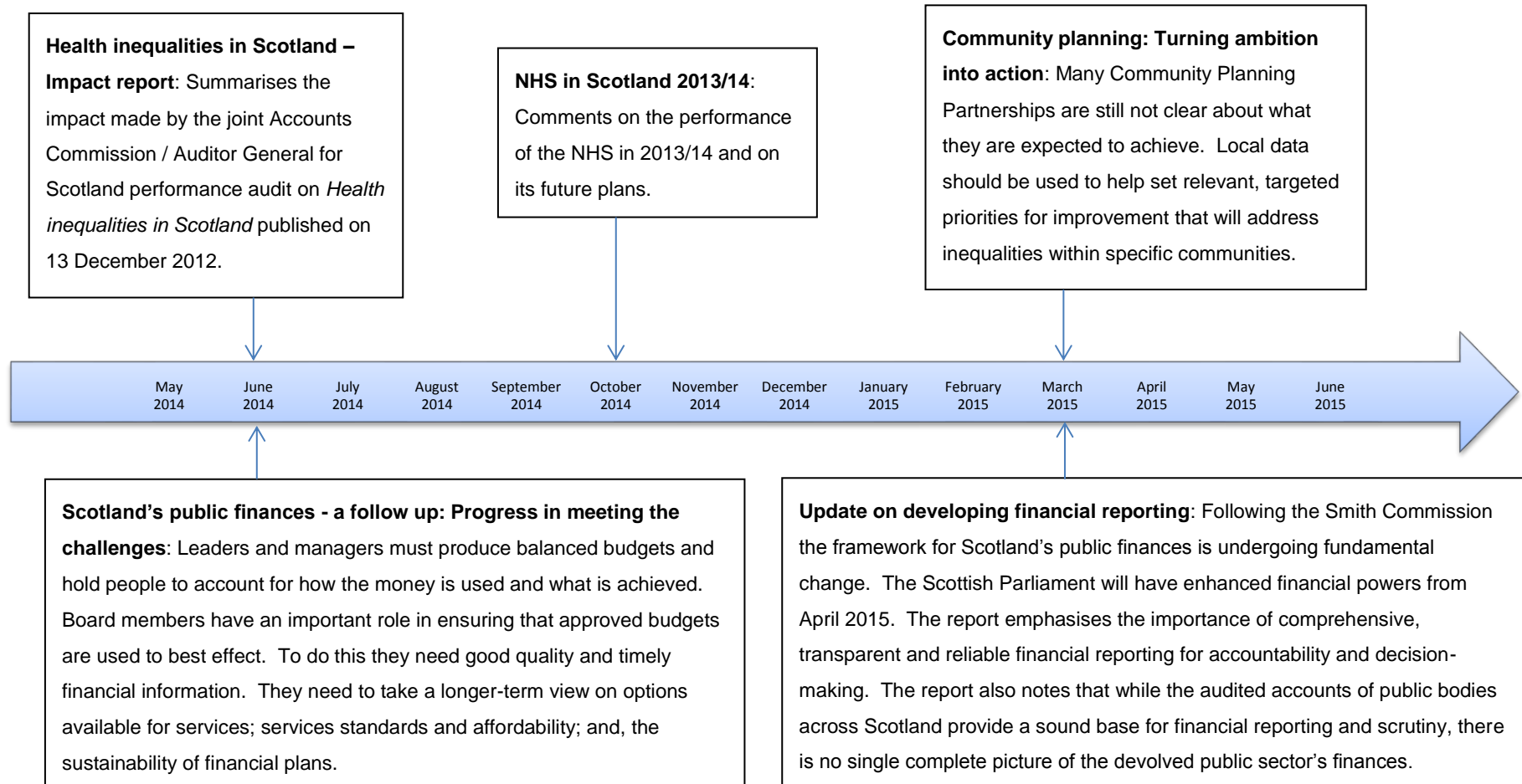
Audit Risk	Assurance procedure	Results and conclusions
<p><b>Group accounts - consolidation</b></p> <p>The different accounting frameworks and the impact on the disclosure of endowment fund realised and unrealised gains resulted in late changes to the 2013/14 financial statements.</p> <p><b>Risk</b></p> <p>As this is still a relatively new process there is a risk of material misstatement.</p>	<ul style="list-style-type: none"> <li>Review component auditor questionnaire issued to endowment fund auditor.</li> <li>Focused testing of consolidation adjustments.</li> </ul>	<p>We undertook detailed testing of the consolidation process and agreed changes to ensure recognition of realised gains.</p> <p>No material misstatements were identified.</p>
<p><b>CNORIS accounting</b></p> <p>A revised approach to the accounting for CNORIS for NHS boards has now been agreed which requires the establishment of a new provision to recognise the amount and board will be obliged to contribute to the CNORIS scheme to meet future obligations.</p> <p><b>Risk</b></p> <p>These accounting changes represent a risk of material misstatement for the financial statements.</p>	<ul style="list-style-type: none"> <li>Audit testing on the prior year adjustment accounting treatment and disclosure.</li> <li>Detailed audit testing of the new provision.</li> </ul>	<p>We undertook detailed testing of the accounting for CNORIS, including the prior year adjustment and agreed some minor changes to improve disclosure.</p> <p>No material misstatements were identified.</p>
<p><b>Valuations</b></p> <p>The financial statements of NHS Lothian include valuations which rely on significant assumptions and estimates.</p> <p><b>Risk</b></p> <p>The extent of subjectivity in the measurement and valuation of these balances represents a risk of material misstatement.</p>	<ul style="list-style-type: none"> <li>Completion of 'review of the work of an expert' for the professional valuer.</li> <li>Focused substantive testing of key areas.</li> </ul>	<p>We reviewed the professional valuer in accordance with ISA 500 and undertook detailed testing of key valuations within the accounts.</p> <p>No material misstatements were identified.</p>

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks identified from the auditor’s wider responsibility under the Code of Audit Practice</b>		
<p><b>Financial sustainability</b></p> <p>The board faces a wide range of financial challenges including achievement of break even by the year end.</p> <p><b>Risk</b></p> <p>There is a risk that the board will not breakeven at the year end.</p>	<ul style="list-style-type: none"> <li>• Monitor updates to the financial plan.</li> <li>• Review financial monitoring reports to the board.</li> <li>• Focused testing of transactions before and after the year end to confirm expenditure and income has been accounted for in the correct financial year.</li> </ul>	<p>We undertook detailed testing of income and expenditure transactions to ensure correctly classified.</p> <p>No material misstatements were identified.</p> <p>All financial targets were achieved.</p>

# Appendix II – Summary of local audit reports 2014/15



# Appendix III – Summary of national reports 2014/15



# Appendix IV – Action plan

No. Page/para	Issue / Risk / Recommendation	Management action / Response	Responsible officer	Target date
<p><b>1</b> 15 / 45</p>	<p><b>Achievement of savings</b></p> <p>The delivery of the cost savings plan for 2015/16 and subsequent years will continue to be challenging.</p> <p><b>Risk</b></p> <p>There is a risk that the board is unable to achieve the required efficiency savings.</p> <p><b>Recommendation</b></p> <p>The board should continue to track the financial performance and achievement of efficiency savings to enable early decisions to be made about the action required.</p>	<p>The savings plan targets for 2015/16 and beyond are extremely challenging and we will continue to monitor and report progress to enable early intervention if required.</p>	<p>Director of Finance</p>	<p>March 2016</p>



No. Page/para	Issue / Risk / Recommendation	Management action / Response	Responsible officer	Target date
<p><b>2</b> 23 / 102</p>	<p><b>Health and social care integration</b></p> <p>The integration of health and social care services has a statutory implementation date of 1 April 2016.</p> <p><b>Risk</b></p> <p>There is a risk that the board and its local authority partners will not be fully prepared for implementation adversely impacting on the effectiveness of service delivery.</p> <p><b>Recommendation</b></p> <p>The board and its local authority partners should continue to put robust arrangements in place for the delivery of integrated health and social care.</p>	<p>Plans are in place for the appointment of key officers along with the development of key governance documents.</p>	<p>Director of Strategic Planning</p>	<p>March 2016</p>

No. Page/para	Issue / Risk / Recommendation	Management action / Response	Responsible officer	Target date
<p><b>3</b></p> <p>26 / 123</p>	<p><b>Performance against HEAT targets</b></p> <p>The board did not achieve all its performance targets in 2014/15, with particular issues identified in delayed discharges and waiting times.</p> <p><b>Risk</b></p> <p>There is a risk that the level of service delivery required to achieve performance targets cannot be delivered within the current financial climate.</p> <p><b>Recommendation</b></p> <p>The board should continue to monitor the performance targets, particularly related to delayed discharges and waiting times, to identify where investment is required to improve performance.</p>	<p>Performance against HEAT targets is regularly monitored and reported with corrective action and investment taken where appropriate / available.</p> <p>Health and social care integration arrangements will further develop the partnership approach to achieving performance targets and improving service quality.</p>	<p>Director of Strategic Planning</p>	<p>March 2016</p>