



Scott-Moncrieff
business advisers and accountants

The State Hospitals Board for Scotland

Annual external audit report to the Board and
the Auditor General for Scotland
2015/16

June 2016

Contents

- Executive summary 1**
- Introduction..... 3**
- Annual accounts..... 5**
- Financial management 11**
- Financial sustainability 15**
- Governance and transparency 18**
- Value for money..... 20**
- Appendix 1: Action plan..... 22**
- Appendix 2: Respective responsibilities of the Board and the Auditor..... 27**

Executive summary

Annual accounts

The State Hospitals Board for Scotland's annual report and accounts for the year ended 31 March 2016 were approved by the Board on 23 June 2016.

Our audit opinions are unqualified and there are no matters which we are required to report to you by exception.

We received draft annual accounts and supporting papers of a good standard, in line with our agreed audit timetable and document requests. We are pleased to report that the audit process ran smoothly, and our thanks go to the finance team for their assistance with our work.

Financial management

The Board has adequate and effective arrangements in place for managing its financial position and its use of resources.

We have evaluated the Board's key financial systems and internal financial controls and determined whether these are adequate to prevent material misstatements in the annual accounts. We have not identified any significant deficiencies in the operation or design of the key financial systems. Arrangements for the prevention and detection of fraud and irregularity are sufficient and appropriate.

Financial sustainability

The Local Delivery Plan (2016-2021) sets out the financial plan for the five year period commencing 2016/17. The Board is forecasting a breakeven position over each of the next five years, although this is dependent on the realisation of further planned savings. For 2016/17, £1.775million of savings are required, apportioned 38%:62% between recurring and non-recurring savings. The Board is aware of the high proportion of non-recurring savings. It is envisaged that savings are likely to come from workforce, capital charges and supplies.

Governance and transparency

In our opinion, the Board's corporate governance arrangements as they relate to standards of conduct and the prevention and detection of bribery and corruption are adequate and appropriate.

- All key financial targets met in 2015/16
- The revenue resource limit was underspent by £11,000
- The capital resource limit was underspent by £29,000
- Savings of £1.353million were reported in the year; an over achievement of £12,000 against the savings target
- A breakeven position is forecast over each of the next five years, subject to the realisation of further planned savings
- 6 of the 12 reported key performance measures were on target for 2015/16. In comparison to 2014/15, 4 key performance measures had improved, 6 were comparable and in 2 performance had declined.

Value for money

The Board has appropriate performance management arrangements in place which support the achievement of value for money.

The Board receives reports on organisational performance and finance at every meeting. Finance and performance reports are based around the local delivery plan and its associated targets, measures and outcomes.

Conclusion

This report concludes our audit for 2015/16. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK and Ireland) and Ethical Standards.

Scott-Moncrieff June 2016

1

Introduction

Introduction

1. This report summarises the findings from our 2015/16 audit of the State Hospitals Board for Scotland ('the Board').
2. The scope of our audit was set out in our External Audit Plan, which was presented to the Audit Committee in January 2016.
3. The main elements of our work in 2015/16 have been:
 - an audit of the Board's annual report and accounts;
 - a review of governance arrangements, internal controls and financial systems; and
 - completion of targeted follow up work in relation to Audit Scotland's national performance report "*Scotland's Public Sector Workforce*".
4. The Board is responsible for preparing annual accounts that show a true and fair view and for implementing appropriate internal control systems. The weaknesses or risks identified are only those that have come to our attention during our normal audit work, and may not be all that exist. Communication in this report of matters arising from the audit of the annual report and accounts or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.
5. This report contains an action plan with specific recommendations, responsible officers and dates for implementation. Senior management should assess these recommendations and consider their wider implications before deciding appropriate actions. Each recommendation is given a grading to help the Board assess their significance and prioritise the actions required.
6. This report is addressed to both the Board and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk.
7. We would like to thank all members of the Board's management and staff who have been involved in our work for their co-operation and assistance during our audit work.

2

Annual accounts

Annual accounts

8. The Board's annual accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources. The respective responsibilities of the Board and the auditor in relation to the annual accounts are outlined in Appendix 2.
9. In this section we summarise the issues arising from our audit of the 2015/16 annual accounts.

Overall Conclusion

An unqualified audit opinion on the annual accounts

10. The annual accounts for the year ended 31 March 2016 were approved by the Board on 23 June 2016. We reported within our independent auditor's report:
 - an unqualified opinion on the annual accounts;
 - an unqualified audit opinion on regularity; and
 - an unqualified audit opinion on other prescribed matters.
11. We are also satisfied that there are no matters which we are required to report by exception.

Good administrative processes were in place

12. We received draft annual accounts and supporting papers of a good standard, in line with our agreed audit timetable. We are pleased to report that the audit process ran smoothly, and our thanks go to the finance team for their assistance with our work.
13. The annual accounts were submitted to the Scottish Government and the Auditor General for Scotland by the 30 June 2016 deadline.

Our assessment of risks of material misstatement

14. The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. Our audit procedures relating to these matters were designed in the context of our audit of the annual accounts as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the annual accounts is not modified with respect to any of the risks described in exhibit 1 below.

Exhibit 1: Our assessment of risks of material misstatement and how the scope of our audit responded to those risks

1.1 Asset register and revaluation

During 2015/16, the Board moved onto a new fixed asset register; RAM (previously the Board's information was held on the CARS system). There is a risk that the balances have not accurately transferred to the new system.

We also understand that the Board's non-current assets are due to be revalued in March 2016. There is a risk that the new valuations are not accurately reflected in the new fixed asset register and accounted for correctly in the annual accounts.

Excerpt from the 2015/16 External Audit Plan

15. During our audit we reviewed and re-performed reconciliations to confirm that balances in relation to fixed asset were accurately transferred onto the new fixed asset register; RAM. We noted no issues with the transfer of balances to RAM.
16. As part of the transfer process, however, the Board identified that balances held in the revaluation reserve were misstated. The Board carries out a full revaluation of its asset portfolio every five years. In the years between each revaluation exercise, an indexation value is applied to the asset portfolio. The Board has a policy whereby increases in asset

Exhibit 1: Our assessment of risks of material misstatement and how the scope of our audit responded to those risks

values are credited to the revaluation reserve except to the extent to which they reverse an impairment previously recognised in the Statement of Comprehensive Net Expenditure (SOCNE). It was noted during the transfer process, that any increase in asset value (by applying an indexation value) had been credited to the revaluation reserve; and not used to reverse any previous impairment recognised in the SOCNE. As such, a prior period adjustment has been disclosed in the 2015/16 annual accounts. The adjustment has reduced the balance on the revaluation reserve and increased the general fund balance. The total value of the adjustment was £1.863million.

17. As part of our audit we also carried out testing to ensure the new asset valuations were accounted for correctly in the annual accounts. No issues were noted from our review.

1.2 2014/15 contingent liability and provision for redundancy costs

In 2014/15, the Board disclosed a contingent liability in its annual accounts in respect of a particular factor within Agenda for Change.

The Board also recognised redundancy costs for one of its employees. As the outcome of the legal challenge was uncertain, an audit adjustment was made to reclassify the accrued costs as a provision.

We understand that no conclusion has been reached in respect of these cases. There is a risk that these cases are not accounted for in the 2015/16 annual accounts in accordance with the Accounts Manual.

Excerpt from the 2015/16 External Audit Plan

18. We have reviewed both cases as part of our audit work to determine the position as at 31 March 2016 and the associated accounting treatment in the annual accounts.
19. The costs in relation to the Board's 2014/15 'Agenda for Change' contingent liability have been accrued in the year.
20. The Board reached a settlement in the year regarding the 'redundancy' case noted above. Additional costs in relation to the settlement agreement amounted to £63,000 and have been paid in the year. We are satisfied that all costs in relation to this challenge have now been settled and that they have been accounted for in the 2015/16 annual accounts in accordance with the Accounts Manual.

1.3 Revenue recognition

Under international auditing standards, there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the Board could adopt accounting policies or recognise income and expenditure transactions in such a way as to lead to a material misstatement in the reported financial position.

Excerpt from the 2015/16 External Audit Plan

21. While we did not suspect incidences of material fraud and error, we evaluated each type of revenue transaction and documented our conclusions.
22. We have reviewed the controls in place over revenue accounting and found them to be sufficient. We have evaluated key revenue transactions and streams, and carried out testing to confirm that the Board's revenue recognition policy is appropriate and has been applied reasonably. We would however draw your attention to paragraph 35; 'other matters identified during our audit' and the Board's accounting treatment in respect of unspent RRL.

Exhibit 1: Our assessment of risks of material misstatement and how the scope of our audit responded to those risks

A potential audit adjustment has been raised in respect of this. This is not considered to be material and through discussion with the Finance and Performance Management Director the decision was taken not to adjust the annual accounts.

1.4 Management override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the annual accounts. This is treated as a presumed risk area in accordance with ISA 240.

Excerpt from the 2015/16 External Audit Plan

23. We have not identified any indications of management override in the year. We have reviewed the Board's accounting records and obtained evidence to ensure that any significant transactions outside the normal course of business were valid and accounted for correctly. We have also reviewed the journal entries processed in the period and around the year end.

Our application of materiality

24. The assessment of what is material is a matter of professional judgement and involves considering both the amount and the nature of the misstatement. This means that different materiality levels will be applied to different elements of the annual accounts.
25. Our initial assessment of materiality for the annual accounts was £525,000. We revised our assessment, following receipt of the draft annual accounts, to £530,000 and it remained at this level throughout our audit. Our assessment of materiality equates to approximately 1.5% of the Board's Revenue Resource Limit (RRL). A key target for the Board is achieving a breakeven position against its Revenue Resource Limit. We consider the RRL to be one of the principal considerations for the users of the accounts when assessing the financial performance of the Board.
26. We set a performance materiality for each area of work based on a risk assessment for the area and percentage application of overall materiality. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means we are performing a greater level of testing on the areas deemed to be of significant risk of material misstatement.

Performance testing thresholds used are set out in the table below (these were revised following our initial assessment following a review of our firm's procedures):

Area risk assessment	Weighting	Performance materiality
High	45%	£371,000
Medium	55%	£291,500
Low	70%	£238,500

27. We agreed with the Audit Committee that we would report all audit differences in excess of 1% of the overall materiality figure, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the annual report and accounts.

Audit differences

28. We are pleased to report that there were no material adjustments to the draft annual accounts that have had an impact on the outturn against the Revenue Resource Limit (RRL). We identified some disclosure and presentational adjustments during our audit, which have been reflected in the final set of accounts.
29. We identified two audit differences during our work that have not been adjusted for in the annual accounts. These two differences are not considered to be material to the annual accounts, either individually or in aggregate. Through discussion with the Finance and Performance Management Director the decision was taken not to adjust the annual accounts. These unadjusted items are included in the representation letter.

Board representations

30. We have requested that a signed representation letter be presented to us at the date of signing the annual accounts.

An overview of the scope of our audit

31. The scope of our audit was detailed in our External Audit Plan, which was presented to the Audit Committee in January 2016. The plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Board. This ensures that our audit focuses on the areas of highest risk. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.
32. At the planning stage we identified the significant risks that had the greatest effect on our audit. Audit procedures were then designed to mitigate these risks.
33. Our standard audit approach is based on performing a review of the key accounting systems in place, substantive tests and detailed analytical review. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit manager and audit partner. In performing our work, we have applied the concept of materiality, which is explained earlier in this

report.

Regularity

34. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts. We did not identify any instances of irregular activity.

Other matters identified during our audit

Treatment of unspent RRL

35. In 2015/16 the Board has deferred income to the value of £560,000 in its annual accounts. On review of this amount we noted that £487,000 relates to unspent RRL allocation. This should have been presented in the annual accounts as an underspend in the year and approval sought from the SGHSCD to carry this forward into 2016/17. An audit difference has been raised in respect of this. This has not been adjusted for in the annual accounts.

Action plan point 1

Follow up of prior year recommendations

36. As part of our audit we followed up the recommendations we raised in 2014/15. The table below indicates that four recommendations are yet to be fully implemented. Further detail on these recommendations is included in the action plan at Appendix 1.

Number of recommendations raised in 2014/15	Complete	Outstanding
10	6	4

Qualitative aspects of accounting practices and financial reporting

37. We have considered the qualitative aspects of the financial reporting process including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the annual accounts. The following table summarises our findings:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	The significant accounting policies, which are disclosed in the annual accounts, are considered appropriate to the Board.
The timing of the transactions and the period in which they are recorded.	We did not identify any concerns over the timing of transaction or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	The accounting estimates and judgements used by management in preparing the annual accounts are considered appropriate. The principal areas of estimates and judgements have been: asset depreciation rates and the valuation of provisions. Where appropriate, the Board has utilised the work of independent experts or industry practice to support the estimates made.
The potential effect on the annual accounts of any uncertainties, including significant risks and related disclosures that are required.	We have not identified any uncertainties, including any significant risk or required disclosures, which should be included in the annual accounts.
The extent to which the annual accounts have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed.	From the testing performed, we identified no significant unusual transactions in the period.
Apparent misstatements in the annual report or material inconsistencies with the annual accounts.	The annual report contains no material misstatements or inconsistencies with the annual accounts.
Any significant annual accounts disclosures to bring to your attention.	There are no significant annual accounts disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately.
Disagreement over any accounting treatment or annual accounts disclosure.	While some disclosure and presentational adjustments were made through the audit process there was no material disagreement during the course of the audit over any accounting treatment or disclosure.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

3

Financial management

Financial management

38. Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. It is the Board's responsibility to ensure that its financial affairs are conducted in a proper manner.

Overall conclusion

39. We concluded that the Board has effective arrangements in place for financial management and the use of resources. Our conclusion is based on a review of the Board's

key financial systems, financial performance and financial reporting.

The Board's financial performance in 2015/16

40. The Board has to work within the resource limits and cash requirements set by the Scottish Government Health and Social Care Directorates (SGHSCD). As shown in the table below, the Board met all of its key financial targets in 2015/16.

Exhibit 2: Performance against key financial targets

Financial target	Target £'000	Actual £'000	Underspend £'000	Target achieved
Revenue Resource Limit - Core	32,303	32,292	11	
Revenue Resource Limit – Non core	2,776	2,776	0	
Revenue Resource Limit	35,079	35,068	11	Yes
Capital Resource Limit	300	271	29	Yes
Cash Requirement	32,407	32,407	0	Yes

Source: Annual Report and Accounts for the year ended 31 March 2016

41. The Board reported an £11,000 under-spend against its revenue resource limit (RRL). At the outset the Board forecast a breakeven position for the year. The outturn includes a carry forward of £90,000 reported in 2014/15. This was received as a non-recurring revenue allocation during 2015/16.

42. During the year the Board reported over spends against certain budgets. Throughout the year nursing costs were higher than budgeted with overtime contributing significantly to that spend. This is consistent with the prior year when action was taken to address the financial position, however cost pressures in this area continue to be a challenge for the Board.

43. The most significant over spends occurred within the General Manager directorate. This is the Board's largest directorate in terms of staffing and budget allocation. At the year-end, an over spend of £512,000 was reported against this directorate. This was offset against under spends reported by other directorates, including the corporate functions and medical, which under spent by £154,000 and £186,000 respectively in 2015/16. Underspends in medical are largely due to having fewer recharges for doctors in training from other boards. Corporate functions underspends are due largely to vacancies in the year.

Exhibit 3: Performance against budget

Function	Annual Budget £'000	Actual £'000	Variance £'000
Corporate functions	7,819	7,665	154
General manager	22,409	22,929	(520)
Medical	2,284	2,098	186
Nursing non-ward	1,071	906	165
Security	1,461	1,446	15
Total	35,044	35,044	0

Source: Finance report as at 31 March 2016

44. Within the General Manager directorate, ward nursing costs were approximately £978,000 over budget in 2015/16 (£1.163million in 2014/15). Nursing overtime costs continue to be a significant cost pressure for the Board; this is after allowing for an increase in the overtime budget of £300,000. Due to the nature of the service provided by the Board, all nursing shifts which are scheduled on wards and are then affected by sickness, high levels of clinical intensity and holiday absence are required to be filled in order to reduce risk to staff. As such, the Board incurs higher levels of overtime costs.
45. The over spend in nursing is partially offset by underspends in other General Management areas including Skye Centre, Dietetics and Allied Health Professionals. Actions taken by the Board in 2014/15, including the closure of one of the wards and the reduction in night shift staffing in July 2014 did not result in the expected fall in nursing costs and overtime. Since July 2014 there has been a significant and sustained rise in the levels of clinical activity, including for example, covering patients boarding out at general hospitals and those patients who have an increased observation status.
46. In order to achieve a balanced outturn position, the Board was required to identify £1.342million in efficiency savings. The Board delivered £1.353million in savings in 2015/16 exceeding its savings target by £12,000. £910,000 of these savings (67%) are non-recurring and are mainly attributable to vacancy management.
47. Although the Board has achieved its efficiency targets in 2015/16, the LDP for 2016/17 highlights £435,000 of unidentified efficiency savings. This is due to a number of issues including staff cost pressures, increased pensions and national insurance costs and general increases in utility costs. A savings plan for workforce, capital charges and supplies has been drafted; however additional savings may need to be identified if the on-going costs are higher than forecast.

Exhibit 4: Efficiency savings

Source of savings	Target as per LDP £'000	Actual savings £'000	Variance under/(over) achieved £'000
Workforce – pay non-recurring	544	687	143
Workforce – pay recurring	389	291	(98)
Non pay non-recurring (part hand back)	234	223	(11)
Non pay recurring	175	152	(22)
Savings as at 31 March 2016	1,342	1,353	14

Source: Finance report as at 31 March 2016

Capital resource limit

48. The Board's initial capital resource allocation was £300,000 against which a total spend of £271,000 was incurred.
49. The next significant capital project to be undertaken by the Board is the planned security refurbishment in 2017/18 – estimated at £5million. It is envisaged that the projected level of available resource will present a major challenge for implementation of the Property and Asset Management Strategy, particularly regarding security and IM&T equipment replacement programmes.

Systems of internal control

50. We have evaluated the Board's key financial systems and internal financial controls to determine whether they are adequate to prevent material misstatements in the annual accounts. Our approach has included audit testing on the key internal financial controls to confirm that they are operating as intended. We undertake detailed controls testing every three years, or more frequently where the key controls have changed.
51. As reported more fully in our external audit interim report, we did not identify any significant deficiencies in the operation or design of internal financial controls over the Board's key financial systems. Reliance has been placed on these controls during our 2015/16 audit.

Internal audit

52. The Board's internal audit service is provided by KPMG. To avoid duplication of effort and to

ensure an efficient audit process we have taken cognisance of all of the work of internal audit. We are grateful to the KPMG team for their assistance during the course of our work.

Fraud and irregularity

53. In accordance with the Code of Audit Practice, we have reviewed the Board's arrangements for the prevention and detection of fraud and irregularities. Overall we found the Board's arrangements to be sufficient and appropriate.

National Fraud Initiative

54. The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. These exercises are undertaken every two years as part of the statutory audit of the participating bodies.
55. The most recent NFI exercise commenced in October 2014. As part of our 2015/16 audit we monitored the Board's participation in NFI. We submitted an assessment of the Board's participation in the exercise to Audit Scotland on 29 February 2016. Overall we concluded that the Board has actively participated in the NFI exercise. All recommended matches had been investigated by 18 June 2015. Reports on the exercise were presented to the Audit Committee.

4

Financial sustainability

Financial sustainability

56. Financial sustainability looks forward to the medium and longer term to consider whether the Board is planning effectively to continue to deliver its services or the way in which they should be delivered.

financial plans to 2020/21. The Board is forecasting a breakeven position over each of these years although this is dependent on the realisation of its savings plan. The Board expects its core RRL to remain broadly consistent in the short term, as shown below.

Future financial plans

57. The Board has submitted a Local Delivery Plan (LDP) to the SGHSCD which outlines its

Exhibit 5: Anticipated movements in core RRL

	2016/17	2017/18	2018/19	2019/20	2020/21
Core RRL (£'000)	31,868	32,288	32,612	32,934	33,258
Increase/(decrease) on prior year (%)	0%	1.3%	1%	1%	1%

Source: The State Hospitals Board for Scotland Local Delivery Plan 2016/17 – 2020/21

Savings plans are in place

58. The Board is expected to make efficiency savings of between 4% and 5% of its core RRL in each year of the LDP. The LDP notes that

the Board has not identified all of the savings required over the next five years. The table below highlights the split between recurring and non-recurring savings.

Exhibit 6: Savings split between recurring and non-recurring

Savings by type	2016/17	2017/18	2018/19	2019/20	2020/21
Recurring £'000	678	505	502	404	404
Non-recurring £'000	1,097	1,434	1,603	765	860
Non-recurring unidentified £'000	435	599	773	1,106	1,392
Total £'000	1,775	1,939	2,105	2,275	2,450
% ratio (recurring: non-recurring)	38:62	26:74	24:76	21:79	18:82

Source: The State Hospitals Board for Scotland Local Delivery Plan 2016/17 – 2020/21

59. Historically, the Board has been able to achieve the savings required to deliver a breakeven position and it remains confident that, based on the funding assumptions within the LDP, it will continue to do so.

Cost pressures

60. The LDP highlights a number of key assumptions and risks to the delivery of the plan, as outlined below:

- Savings plans – the operational running costs of the site are more than planned. A

savings plan around the workforce, capital charges and supplies has been drawn up; however additional savings may need to be made if the on-going costs are more than forecast. Also year on year it gets harder to identify workforce savings without impacting on patient care or security. If plans fall behind financial balance could be at risk unless other non-pay savings can be found.

- The reduction in capital funding potentially leaves equipment replacement at risk, as the formula allocation will require close control and review to be able to cover any major equipment replacement programmes.

61. The achievement of future financial targets will depend on continuing tight control of expenditure, delivery of a challenging savings plan and may also require some difficult decisions to be taken in areas such as workforce planning. This will be a key area which the Board will have to monitor very closely.

Workforce planning

62. In November 2013, the Accounts Commission and Auditor General for Scotland published a report on Scotland's public sector workforce. The report highlighted a number of key messages on workforce changes across Scotland and made a number of recommendations to the Scottish Government, central government bodies, the NHS, COSLA and local authorities.

63. As part of our 2015/16 audits, Audit Scotland asked us to undertake a follow up review to help in understanding to what extent public bodies are implementing the recommendations and help identify common and emerging issues.

64. Through this work we concluded that, although the Board does not currently have a long term (5-10yrs) workforce plan in place this has been recognised as an area requiring improvement. The Board is at an advanced stage in addressing this with a draft workforce strategy being presented to the June Board for approval. Key findings of our work at the Board include:

- Workforce Strategy will be presented to the June 2016 Board for approval. This has been produced in line with the 6 step methodology.
- No detailed departmental plans are in place however these will be developed to support the strategic workforce plan;
- The Board uses established tools and national benchmarks to measure the impact of service redesign.
- The Board is accredited for the Healthy Working Lives gold award which includes a range of staff welfare interventions.

5

Governance & transparency

Governance and transparency

65. Governance and transparency is concerned with the adequacy of governance, leadership and decision making, and transparent reporting of financial and performance information. The Board is responsible for ensuring the proper conduct of its affairs including compliance with relevant guidance, the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements.

Governance arrangements

66. During our audit we have reviewed the Board's overall governance arrangements, including those relating to standards of conduct, the prevention and detection of bribery and corruption and risk management. Based on our review, we concluded that overall governance arrangements are adequate and appropriate.

Board and senior staff changes

67. The Nursing Director retired in January 2016 and was replaced by the General Manager as the Interim Nursing Director from February 2016. A recruitment exercise is ongoing to find a permanent replacement for the role.

Board self-assessment

68. The Board members are subject to an annual appraisal. This is conducted by the Chair for all non-executive members and the Chief Executive, and by the Chief Executive for executive members. Committees of the Board also undertake an annual self-assessment of their performance and report this to the Board.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

69. In our opinion, the Board's arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption remain adequate and appropriate.
70. We have reviewed the arrangements for adopting and reviewing standing orders, financial instructions and schemes of delegation and complying with national and local codes of conduct.
71. We have previously noted that a large number of policies and procedures are out of date and/or not available to staff. The Board has been working towards addressing this issue.

We have noted the following progress in relation to this action:

Currently, out of 136 policies:

- 73 are up to date;
- 49 are overdue for review;
- 3 are under consolidation; and
- 11 have been updated and reviewed by senior management however they have yet to be distributed to staff.

Risk management

72. Public sector bodies in Scotland currently face increasing demand for quality services, but also have to face the challenge of tighter financial budgets. Effective risk management encourages effective decision making and better use of resources.
73. The Board's risk management arrangements continue to be developed. A full review of the Corporate Risk Register was undertaken in June 2015 by way of a workshop facilitated by KPMG.
74. However, we noted in our Interim Audit Report that the Board's Risk Management Strategy has not been reviewed since 2009, having fallen due for review in 2012, and does not reflect current arrangements. This was yet to be updated at the time of our final audit visit and has been raised through our external audit interim report for the attention of management.

6

Value for money

Value for money

75. Value for money is concerned with using resources effectively and continually improving services. In this section we report on our audit work as it relates to consideration of the Board's reported performance and to what extent this demonstrates continuous improvement.

Overall conclusion

76. We found that the Board has appropriate performance management arrangements in place which support the achievement of value for money.

Performance management framework

77. The Board has developed a performance management framework and receives reports on organisational performance and finance at every meeting. Performance reports are based on the Board's local delivery plan (LDP) and its associated targets and measures.

78. The Local Delivery Plan (LDP) sets out the Board's performance expectations against the targets which are aligned with the ministerial objectives of; Health improvement for people in Scotland; Efficiency/governance improvements; Access more quickly to service; and Treatment appropriate for patient (HEAT). The Board identified 12 key performance indicators in 2015/16. Progress against key performance indicators has been reported by the Board in its Annual Report and Accounts for the year ended 31 March 2016.

79. 6 of the Board's 12 reported key performance measures were on target for 2015/16. In comparison to 2014/15, 4 key performance measures had improved, 6 were comparable and in 2 performance had declined.

80. The Board also receives regular and detailed performance and financial information which facilitates scrutiny and challenge. Key risk factors which may impact on achievement of financial and non-financial outcomes are identified and discussed.

Best value

81. The Board fully embraces the principles of best value and has integrated these principles into the management of the Board. To demonstrate

compliance with these principles, the Board decided to self-assess itself against Audit Scotland's best value toolkits. It was originally intended that all 18 toolkits would be used over a five year period. However progress was initially slow. The final four toolkits have been completed in 2015/16. These were:

- Community Engagement;
- Customer Focus;
- Equalities; and
- Challenge and Improvement.

82. The Board now intends to create an Action Plan to address the issues noted. It is expected that this will be in place by July 2016.

7

Appendices

Appendix 1: Action plan

Our action plan details the control weakness that we have identified during the course of our audit. It also details four further control weaknesses identified in previous audit visits which we consider remain outstanding. The action plan details the officer responsible for implementing the recommendation and an implementation date. The Board should assess the recommendation for wider implications before approving the action plan.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work, and may not be all that exist. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements. Communication in this report of matters arising from the audit of the annual accounts or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Action plan grading structure

To assist the Board in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated.

The grading structure for our recommendations is as follows:

Grade 5	Very high risk exposure – major concerns requiring Board attention
Grade 4	High risk exposure – material observations requiring senior management attention
Grade 3	Moderate risk exposure – significant observations requiring management attention
Grade 2	Limited risk exposure – minor observations requiring management attention
Grade 1	Efficiency / housekeeping point

Action plan point	Issue & Recommendation	Management Comments
1	<p>Treatment of unspent RRL</p> <p>In 2015/16 the Board has deferred income to the value of £560,000 in its annual accounts. On review of this amount we noted that £487,000 relates to unspent RRL allocation. This should have been presented in the annual accounts as an underspend in the year and approval sought from the SGHSCD to carry this forward into 2016/17. An audit difference has been raised in respect of this. This has not been adjusted for in the annual accounts</p> <p>We recommend that the Board review its accounting treatment in respect of unspent RRL in future years.</p>	<p>Correct accounting treatment will be applied from 2016/17 onwards.</p> <p>Responsible Officer: Head of Management Accounts</p> <p>Completion Date: 2016/17</p>
<p>Rating</p>		
<p>Grade 3</p>		
<p>Paragraph ref</p>		
<p>35</p>		

Outstanding issues from our 2014/15 audit

Title	Issue identified & Recommendation	Management Comments	2015/16 update
2014/15 Interim report	<p>The Board's Risk Management Strategy has not been reviewed since 2009, having fallen due for review in 2012, and does not reflect current arrangements.</p> <p>There is a risk that management are not aware of their relevant roles and responsibilities for risk management, including reporting and recording of risks.</p> <p>The risk management strategy should be refreshed to reflect current practices.</p>	<p>Risk Strategy will be updated by August 2015.</p> <p>To be actioned by: Risk Management Team Leader/Finance and Performance Management Director</p> <p>Timescale: August 2015</p>	<p>Accepted and awaiting Business Support review underway.</p> <p>To be actioned by: Chief Executive/Finance and Performance Management Director</p> <p>Completion Date: 2016/17</p>
Risk management strategy			
Grade: 3			

Title	Issue identified & Recommendation	Management Comments	2015/16 update
2014/15 Annual Report	<p>There are no succession plans in place for the finance function.</p> <p>Succession issues exist for the finance function as more than half the team are over the age of 50.</p> <p>This presents a certain level of risk to continuity of the finance function.</p> <p>We would encourage the Board to consider these succession issues as part of its wider workforce review scheduled for 2015/16.</p>	<p>Succession planning is being addressed across a number of areas of the State Hospital workforce, and the finance function will be included within the overall workforce plan review.</p> <p>Responsible officer: Human Resources Director</p> <p>Implementation date: 2015/16</p>	<p>Succession planning review still not complete and will be actioned in 2016/17.</p> <p>To be actioned by: Human Resources Director</p> <p>Completion Date: 2016/17</p>
Succession Plan			
Grade: 2			

Title	Issue identified & Recommendation	Management Comments	2015/16 update
2014/15 Annual Report	<p>There is currently limited information within the LDP and performance reports on how the planned spending will contribute to the Board's intended outcomes.</p> <p>The Board should look to address this issue in future reports and within the next annual LDP through implementation of a formal mechanism for monitoring and reporting on how spending decisions are contributing to outcomes.</p>	<p>Noted – future reports will include this recommendation.</p> <p>Responsible officer: Finance and Performance Management Director</p> <p>Implementation date: June 2016</p>	<p>Agreed and is being actioned in 2016/17.</p> <p>To be actioned by: Finance and Performance Management Director</p> <p>Completion Date: January 2017</p>
Financial strategy and sustainability			
Grade: 2			

Title	Issue identified & Recommendation	Management Comments	2015/16 update
2014/15 Annual Report	<p>As part of our 2014/15 audit we reviewed the processes the Board has adopted to self-assess itself against these toolkits. Our review concluded that these processes are not operating as effectively as they could be.</p> <p>We would encourage the Board to consider other options, instead of the Audit Scotland best value toolkits, to enable it to demonstrate compliance with best value principles.</p> <p>Management should present a summary of the findings from its self-assessment against a toolkit, along with identified actions for improvement to, as a minimum, the Audit Committee which has delegated responsibility for assessing the Board's compliance with best value principles. The actions for improvement should be presented in an action plan which sets out the responsible officer and timescale for completion.</p> <p>The findings should highlight where management has decided that 'basic' or 'better' practice is quite acceptable and appropriate.</p>	<p>The majority of toolkits are now completed – other options will not be addressed until the final set of toolkits are completed in 2015/16.</p> <p>Agreed and noted – a summary of actions will be presented to the Audit Committee from the next meeting of September 2015.</p> <p>Responsible officer: Finance and Performance Management Director</p> <p>Implementation date: June 2016</p>	<p>All toolkits have now been completed and will be reviewed with the intention of completing an Action Plan.</p> <p>To be actioned by: Finance and Performance Management Director</p> <p>Completion Date: September 2016</p>
Best value			
Grade: 2			

Appendix 2: Respective responsibilities of the Board and the Auditor

It is the responsibility of the Board and the Chief Executive, as Accountable Officer, to prepare financial statements in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder.

In preparing the annual report and accounts, the Board and the Chief Executive, as Accountable Officer are required to::

- apply on a consistent basis the accounting policies and standards approved for the NHS Scotland by Scottish Ministers;
- making judgements and estimates on a reasonable basis;
- stating whether applicable accounting standards as set out in the Financial Reporting Manual have not been followed where the effect of the departure is material; and
- preparing the accounts on a going concern basis unless it is inappropriate to presume that the Board will continue to operate.

Board members are also responsible for:

- keeping proper accounting records which are up to date; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditor responsibilities

We audit the annual report and accounts and give an opinion on whether:

- they give a true and fair view in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers of the state of the board's affairs as at 31 March 2016 and of its net operating cost for the year then ended;
- they have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015/16 FReM;
- they have been prepared in accordance with the requirements of the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers;
- expenditure and income in the annual accounts was incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers;
- the Remuneration and Staff Report to be audited has been properly prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers; and
- the information given in the Performance Report for the financial year for which the annual accounts are prepared is consistent with the annual accounts.

We are also required to report if, in our opinion:

- adequate accounting records have not been kept; or
- the annual accounts and the part of the Remuneration and Staff Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Governance Statement does not comply with guidance from the Scottish Ministers; or
- there has been a failure to achieve a prescribed financial objective.

The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the annual accounts and associated documents such as governance statements, but providing a view also, where appropriate, on matters such as propriety, performance and the use of resources in accordance with the principles of Best Value and 'value for money'.

Best value, use of resources and performance

- To review the Board's arrangements for managing its performance and for securing economy, efficiency and effectiveness in its use of resources.

Corporate governance

To review and report on the Board's arrangements as they relate to:

- Its review of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and prevention and detection of corruption; and
- financial position.

Independence

ISA 260 requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence. We confirm that we will comply with APB Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Scott-Moncrieff and the Board, its Board members and senior management that may reasonably be thought to bear on our objectivity and independence.



Scott-Moncrieff
business advisers and accountants