



Scott-Moncrieff
business advisers and accountants

NHS Lothian

Annual report on the 2016/17 audit
to the Board and the Auditor General for
Scotland

June 2017

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Summary

Annual accounts

NHS Lothian approved the annual accounts for 2016/17 on 21 June 2017 and the accounts were submitted, together with this report, to the Scottish Government and Auditor General by the deadline of 30 June 2017.

We have reported unqualified opinions on the financial statements, the regularity of transactions and on other prescribed matters within our independent auditor's report. We were also satisfied that there were no matters which we were required to report by exception.

Wider Scope

The Code of Audit Practice frames the wider scope in terms of four dimensions. We summarise below our conclusions on each dimension.

Financial Management
<ul style="list-style-type: none"> NHS Lothian has adequate and effective arrangements in place for managing its financial position and use of resources, but continues to rely on non-recurring funding to achieve financial balance. We have evaluated NHS Lothian's key financial systems and internal financial controls and determined these are adequate to prevent material misstatements in the annual accounts.
Governance & Transparency
<ul style="list-style-type: none"> Our work on corporate governance focussed on reviewing NHS Lothian's arrangements to ensure effective systems are in place regarding internal control, prevention and detection of fraud and irregularity and standards of conduct. Governance arrangements at NHS Lothian were found to be well-developed and appropriate.

<ul style="list-style-type: none"> Unqualified audit opinion on: <ul style="list-style-type: none"> the financial statements regularity other prescribed matters All key financial targets were met in 2016/17 The revenue resource limit was underspent by £0.32million The Board forecasts a significant recurring deficit position reaching £91.2million by 2021/22 15 of the 29 local delivery plan measures were met in 2016/17.

Financial Sustainability
<ul style="list-style-type: none"> NHS Lothian recognises that a medium term financial strategy is essential to demonstrate how financial sustainability can be achieved. The board faces a significant recurring deficit position in the period to 2021-22, with no clear plans to bridge the financial gap. Difficult decisions about service redesign lie ahead for the board and its partners.
Value for Money
<ul style="list-style-type: none"> A well-established and appropriate performance management framework is in place at NHS Lothian. Clinician-focused quality management arrangements aim to achieve best practice while delivering value for money. Financial pressures mean that the achievement of performance targets is increasingly difficult.



Conclusion

This report concludes our audit for 2016/17. 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 2017

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Introduction

Introduction

1. This report summarises our findings from the 2016/17 audit of NHS Lothian.
2. We outlined the scope of our audit in our external audit plan, which we presented to the Audit and Risk Committee in February 2017. The core elements of our audit work in 2016/17 have been:
 - an interim audit of NHS Lothian's key financial systems and governance arrangements;
 - an audit of NHS Lothian's 2016/17 annual report and accounts, including a review of the Governance Statement;
 - a review of arrangements as they relate to the four dimensions of wider-scope public audit: governance and transparency, financial management, financial sustainability and value for money;
 - consideration of the Board's arrangements for taking part in the National Fraud Initiative data-matching exercise; and
 - consideration of the local impact of the national performance report [The Role of Boards](#).
3. NHS Lothian is responsible for preparing annual accounts that show a true and fair view and for implementing appropriate internal control systems. The weaknesses and risks identified in this report 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 financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control
4. We discussed and agreed the content of this report with the Director of Finance. We would like to thank all management and staff for their co-operation and assistance during our audit.
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. We give each recommendation a grading to help NHS Lothian assess the significance and prioritise the actions required.

Adding value through the audit

6. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Board through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Board promote improved standards of governance, better management and decision making and more effective use of resources.
7. We welcome any comments you may have on the quality of our work and this report via: www.surveymonkey.co.uk/r/S2SPZBX
8. This report is addresses both the Board and the Auditor General for Scotland and will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

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Annual accounts

Annual accounts

9. 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*.

Overall Conclusion

An unqualified audit opinion

10. The annual report and accounts for the year ended 31 March 2017 were approved by the Board on 21 June 2017. We have reported within our independent auditor's report:
- an unqualified opinion on the financial statements;
 - an unqualified 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 financial statements 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 finance management and staff for their assistance.
13. The annual accounts were submitted to the Scottish Government and the Auditor General for Scotland prior to the 30 June 2017 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 report and accounts as a whole, and not to express an opinion on individual accounts or disclosures.

1. Health and Social Care Integration and Consolidation of IJB accounts

The integration of health and social care services in the Lothian region came in to effect on 1 April 2015 through the formation of four Health and Social Care Partnerships (East Lothian, Edinburgh, Midlothian and West Lothian). From 1 April 2016, formal responsibility for planning health and social care services for these areas has been delegated to four Integration Joint Boards (IJBs). This represents a fundamental change in the way the "integration functions" are governed across Lothian.

The integration of health and social care services also has a direct impact on the Board's annual accounts. It is expected that IJBs will be accounted for as joint ventures between the Board and the respective local authority partner. This would have a range of impacts on the board's financial statements, across the primary statements and notes to the accounts. There would also be notable narrative reporting implications.

At present, it appears likely that the Board will have to approve accounts consolidating transactions with the IJB before the IJB accounts themselves have been approved. To properly inform NHS Lothian's accounts approval process it will be imperative that the Board formally agrees income, expenditure and any related balances with the four IJBs in a timely manner.

There is a risk that the Board does not account for transactions and balances with IJBs correctly in the 2016/17 annual accounts.

Excerpt from the 2016/17 External Audit Plan

15. We have reviewed the accounting treatment adopted by the Board in relation to the consolidation of the IJBs as joint ventures and found this to be in line with the requirements of the Government Financial Reporting Manual (FRoM).


2. PFI, NPD and related capital assets

The Board has a range of facilities which are funded through the PPP/PFI mechanism, including The Royal Infirmary of Edinburgh, Midlothian Community Hospital, Ellens Glen and Findlay House. The cumulative estimated base capital value of these agreements is in excess of £200million.

We are aware of ongoing work in relation to one of the PFI agreements (Ferryfield) where the Board is in discussion with the PFI provider as to the way forward with that facility on expiry of the contract term. This facility does not revert to Board ownership on contract expiry, but is a part of the ongoing estates strategy for healthcare provision.

There is a risk that the Board's financial statements do not show the correct PPP/PFI accounting entries and related commitments, and that the unitary payments in relation to these facilities are not correctly accounted for. There are also implications for the financial position and estates strategy on the Board which need to be fully considered.


Excerpt from the 2016/17 External Audit Plan

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16. The Royal Edinburgh Hospital Phase 1 new Hub facilities became operational in 2016/17 at a value of £38.382 million. The contract agreed over this Hub asset runs until December 2041 at which point ownership of the facilities will transfer to the Board. In practice, the accounting arrangements for the hospital redevelopment are consistent with those used for the Board's legacy PPP/PFI assets. We reviewed the Board's PFI and Hub accounting and disclosures against the requirements of the FReM and against the underlying contracts. We found that the Board has accounted for its PFI and Hub assets appropriately.
 17. The Board's PFI and Hub assets have been subject to revaluation, in accordance with the FReM and international accounting standards. As at 31 March 2017 the combined capital value of all eight facilities was £246.986million. The financial statements also recognise the present value of the remaining lease payments on these assets as liabilities in the balance sheet. At the year end, the remaining lease payments amounted to £217.918million. We consider this to be appropriate accounting treatment.
 18. The Ferryfield lease is currently under review by the Board. The property was subject to revaluation and the shorter useful life has been taken into account. We will consider the results of the lease negotiations when they are completed as part of our 2017/18 audit work.

3. Revenue Recognition

Under ISA 240 - The auditor's responsibilities relating to fraud in an audit of financial statements, 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 in a way that materially misstates the Board's financial performance.

Excerpt from the 2016/17 External Audit Plan

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19. We have gained reasonable assurance on the completeness and occurrence of income and we are satisfied that income is fairly stated in the financial statements. To inform our conclusion we evaluated the Board's key revenue streams and reviewed the controls in place over revenue accounting by the Board. We also carried out testing to confirm that the Board's revenue recognition policy is appropriate and has been applied consistently throughout the year.

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 financial statements. This is treated as a presumed risk area in accordance with ISA 240.

Excerpt from the 2016/17 External Audit Plan

20. 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 management estimates and the journal entries processed in the period and around the year end.

Our application of materiality

21. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.
22. Our initial assessment of materiality for the financial statements was £23million, approximately 1.4% of the Board's RRL. Achieving a breakeven against RRL is a key target for the Board and one of the principal considerations for the users of the accounts when assessing financial performance. We consider our initial materiality assessment to have remained appropriate throughout our audit.
23. We set a level of performance materiality for each area of work which is based on a risk assessment for the area.
24. We have performed audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we performed a greater level of testing on the areas deemed to be of significant risk of material misstatement

Area risk assessment	Weighting	Performance materiality
High	40%	£9.2million
Medium	55%	£12.65million
Low	70%	£16.1million

25. We agreed to report any misstatements identified through our audit that fall into one of the following categories:
- All material corrected misstatements;
 - Uncorrected misstatements over £230,000;
 - Misstatements below £230,000 that we believe warrant reporting on qualitative grounds.

Other matters

26. We did not identify any material weaknesses in the accounting and internal control systems that we consider could result in a material misstatement in the financial statements.

Audit differences

27. There were no material adjustments to the draft financial statements arising from our audit. We did identify some minor disclosure and presentational adjustments and these have been reflected in the signed financial statements.

Board representations

28. The Board has complied with our request for a signed representation letter, covering a number of issues, as presented to us at the date of signing the financial statements.

An overview of the scope of our audit

29. We detailed the scope of our audit in our external audit plan. We presented the plan to the Audit and Risk Committee in February 2017. Our 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.
30. 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.
31. At the planning stage we identified the significant risks that had the greatest effect on our audit. We then designed audit procedures to mitigate these risks. We base our standard audit approach on performing a review of the key accounting systems in place, substantive tests and detailed analytical review.

32. 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.

Regularity

33. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts. This included specific testing over the regularity of transactions. We did not identify any instances of irregular activity.

Qualitative aspects of accounting practices and financial reporting

34. 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 financial statements. 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 financial statements, 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 transactions 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 financial statements are considered appropriate. The principal areas of estimates and judgements have been: property valuations, 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.

Qualitative aspect considered	Audit conclusion
The potential effect on the financial statements 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 financial statements (beyond the existing disclosures made).
The extent to which the financial statements 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 and accounts or material inconsistencies with the financial statements.	The annual report and accounts contain no material misstatements or inconsistencies with the financial statements.
Any significant financial statements disclosures to bring to your attention.	There are no significant financial statements 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 financial statements disclosure.	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.

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Financial management

Financial management

35. Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. The Board must ensure that its financial affairs are conducted in a proper manner.

37. Our conclusion is based on a review of NHS Lothian's financial performance, underlying financial position, financial reporting and achievement of savings targets. This section of the report outlines our key findings.

Overall conclusion

NHS Lothian has effective arrangements in place for financial management and the use of resources

36. We have concluded that NHS Lothian has effective arrangements in place for financial management and the use of resources.

Financial performance in 2016/17

NHS Lothian met its key financial targets in the year

38. NHS Lothian has to work within the resource limits and cash requirements set by the Scottish Government. In 2016-17, the Board's final cash requirement was £1.618 billion (2015-16: £1.509 billion). As shown below, NHS Lothian met all of its key financial targets in 2016/17.

Financial Target	Limit £000	Actual £000	Variance £000	Target achieved?
Core revenue resource limit	1,457,485	1,457,146	339	Yes
Non-core revenue resource limit	141,894	141,894	-	Yes
Core capital resource limit	96,480	96,480	-	Yes
Non-core capital resource limit	40,482	40,482	-	Yes
Cash requirement	1,618,169	1,618,168	1	Yes

Delivering financial balance

39. The Local Delivery Plan was based on NHS Lothian managing a funding gap of £101.7 million (6.9% of the budget) to achieve financial balance. The accompanying table outlines the additional cost pressures identified within the Local Delivery Plan.

40. Financial pressures in 2016-17 reflected the impact of pay and national insurance changes, the growing demographic challenge caused by the growth and nature of the population in Lothian, strategic investments and the implementation of national policies.

The Local Delivery Plan 2016-17 set out a challenging financial position to manage increasing cost pressures	2016-17 uplift £m
Baseline pressures, including unachieved efficiencies from prior years	21.594
Projected expenditure uplifts and commitments	68.775
Essential service developments	4.91
Projected additional costs	£95.279
Net annual funding uplift	(13.126)
Financial Gap before recovery actions	£82.153

41. The Local Delivery Plan outlined the strategy to address the financial gap:

- Financial recovery plans (£27.4 million)
- Non-recurring flexibility – budget set aside for the new Royal Hospital for Sick Children (£4.8 million)
- Provisions and year end management (£16 million)
- General Reserves (£13 million).

42. The financial plan placed significant reliance on the use of non-recurring reserves to deliver financial balance. Over £33 million of the financial pressures in 2016-17 (around 2% of the overall budget), were planned to be funded from non-recurrent sources. The financial gap after recovery actions was £20.944 million.

43. During 2016-17, NHS Lothian reported an overspend against budget of £12.728 million, primarily as a result of an overspend against pay of £5.642 million, and a prescribing overspend of £9.06 million.

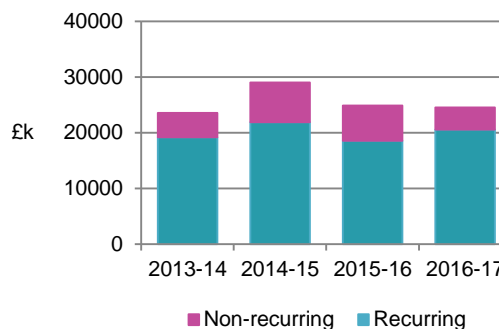
44. Financial balance was achieved by using reserves flexibility of £13.06 million. Additional resources were received relating to NRAC (£6 million) and other Outwith DEL funding (£4.498 million). Additional flexibility was achieved because of delays in the capital investment programme.

Efficiency savings

NHS Lothian did not achieve all of the savings planned in 2016-17

45. As part of NHS Lothian's 2016-17 financial plan, a total of £34.279 million of savings was required. NHS Lothian delivered £24.52 million of savings, but as the follow chart highlights, as in prior years around £3.98 million (16%) of the savings achieved were on a non-recurrent basis.

Reliance on non-recurring savings places additional pressures on the future financial position



46. A key element of NHS Lothian's Financial Plan is the recovery actions agreed by budget holders across Directorates to deliver savings. In 2016-17, NHS Lothian introduced a revised approach to managing the budget to place additional focus on the savings targets that have not been achieved in prior years.

47. At the start of 2016-17, a legacy gap of £12.8 million was carried forward from prior years. This gap has been closed to £6.8 million, but the shortfall of £9.759 million in savings targets for 2016-17 has been added as an additional financial pressure to the 2017-18 financial plan.

NHS Lothian has effective budget setting and monitoring arrangements in place

48. We have considered NHS Lothian's system of budgetary control and financial management and did not identify any significant deficiencies. Comprehensive financial regulations and policies are in place which are subject to regular review and are available on the Board's Finance Online intranet site.

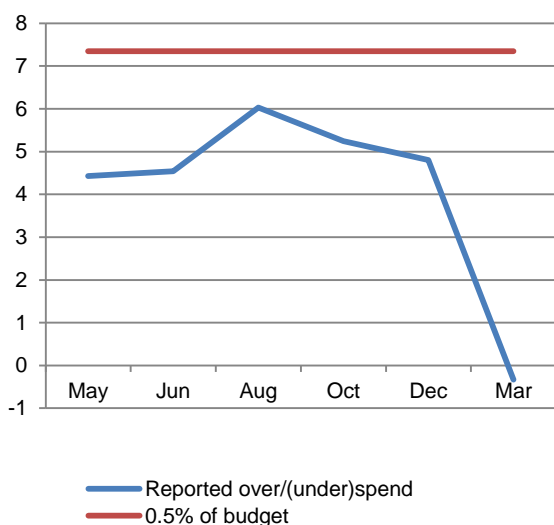
49. NHS Lothian has also recently introduced improvements to the financial performance information available to budget holders, including the use of Tableau dashboards to share financial data on a monthly basis.

50. Financial monitoring reports are submitted to all meetings of NHS Lothian, the Finance and Resources Committee and Corporate Management Team. The reports include forecast outturn positions, and explanations of key movements in the year. As highlighted below, NHS Lothian demonstrated strong financial management and was able to managed expenditure against the RRL to within 0.5% of the budget throughout the year.

51. The Finance and Resources Committee was able to provide significant assurance within the governance framework that the Board is operating within its revenue budget and the limits of the Board's expressed risk appetite and tolerance.

- Construction of the new £150 million Royal Hospital for Sick Children and Department of Clinical Neurosciences has continued. Handover of the building is planned for October 2017, with services moving in by Spring 2018.
- Marketing has begun on the Bangour Village site and the Royal Hospital for Sick Children will be subject to a community right to buy decision.
- The lease in Pentland House terminates in November 2017 and significant work has been undertaken to decant non-clinical staff to Waverley Gate, saving an estimated £1 million per year.

NHS Lothian managed its budget to within 0.5% throughout the year and provided clear explanations for variances



Good progress was made against the Property and Asset Management Investment Programme

52. The Property and Asset Management Programme underpins the vision for the estate based on the four "stakes" within the Board's Strategic Plan. NHS Lothian invested £96.48million in capital estate projects in 2016-17. Key developments in 2016-17 include:

- Phase one of the Royal Edinburgh Hospital has completed, and patient moves commenced in January 2017.

Prevention and detection of fraud and irregularity

53. Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. We identified no issues in this respect. We found NHS Lothian's arrangements for the prevention and detection of fraud and other irregularities to be satisfactory.

54. The Fraud Liaison Officer provides an annual report to the Audit and Risk Committee outlining any cases that have been referred to Counter Fraud Services, and the progress of any investigations. The Audit and Risk Committee also receive updates on current counter fraud activity at each meeting.

55. In addition, the Counter Fraud Service's estimates of potential fraud relating to claims for exemptions from patient charges for dental and ophthalmic services are monitored. NHS Lothian has a lower rate than the Scottish average for both Dental and Ophthalmic potential fraud.

National fraud initiative

56. The most recent NFI exercise commenced in October 2016 and as part of our 2016/17 audit we monitored the Board's participation in NFI. We found the arrangements for participation in the NFI to be satisfactory.

- 57.** 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.
- 58.** The NFI produces 'matches' by using data matching to compare a range of information held on bodies' systems to identify potential fraud or error. Bodies investigate these matches and record appropriate outcomes based on their investigations.
- 59.** The current NFI exercise identified 7,483 matches for the Board, of which 1,031 were recommended for investigation. Due to circumstances outwith the Board's control, matches relating to payroll data were not released on a timely basis. These matches account for 472 of the total matches (69 of the recommended matches).
- 60.** To date, 790 recommended matches have been concluded upon with no frauds or errors identified.
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4

Financial sustainability

Financial Sustainability

61. 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.

Significant audit risk

62. As outlined in our audit plan, we considered there to be a significant risk to the wider scope of our audit in relation to financial sustainability:

Financial sustainability

The financial position of the Board is known to be challenging, with a significant funding squeeze exacerbating a demanding operating environment and outstripping cost increases being faced by NHS Lothian. Although increases are expected in the resources available to the Board over the next three years, the Board is expected to make very substantial recurring efficiency savings each year. There is a risk that delivery of the Board's efficiency savings plans are at the detriment of services and/or on-going financial health.

Overall Conclusion

NHS Lothian has made the development of a medium term financial strategy a corporate objective for 2017/18

63. NHS Lothian has effective arrangements in place for financial planning and monitoring in the short term. However, until the Board is in a position to agree a medium term financial strategy, the challenging financial outlook continues alongside uncertainty around the sustainability of services at the current levels.

Strategic Planning

64. NHS Lothian published its Strategic Plan *Our Health, Our Care, Our Future* in 2014. The Strategic Plan set out some of the significant challenges facing NHS Lothian as it responds to the health needs of a growing and ageing population.
65. Population projections for 2015-2025 showed an estimated increase of 9% in the total Lothian population. Internal estimates of the financial impact suggest that the population growth and profile changes may add an additional 13% of demand on health resources in Lothian.
66. Since 2009-10, the Scottish Government has used a formula developed by the National Resource Allocation Committee (NRAC) to allocate the majority of budgets for each territorial board.

67. The NRAC formula is based on the population size, with adjustments made to reflect the relative age and gender, and any additional factors such as deprivation levels.
68. When the formula was introduced, NHS Lothian's actual allocation was considerably below the target level of funding. In 2016/17, funding fell around £13million below the NRAC target allocation. In 2017-18, NHS Lothian will receive £19 million in NRAC funding. However, this remains £12m behind the NRAC target allocation for 2017-18, and maintains the relative shortfall in funding between NHS Lothian and other territorial boards.

Financial Projections

The Board's Local Delivery Plan sets out a very challenging financial outlook with no clear plans to deliver recurring financial balance

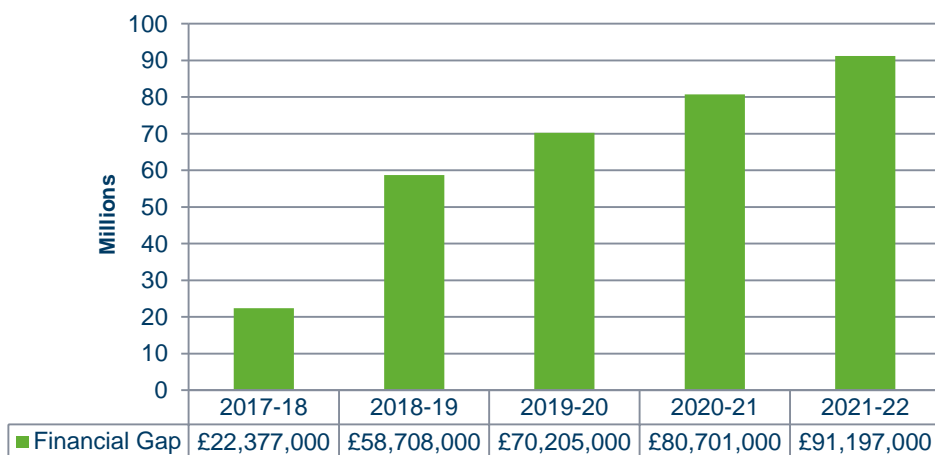
69. NHS Lothian's LDP for 2017-18 outlines a financial gap before recovery actions of £47.916 million. Financial recovery actions totalling £25.540 million have been identified but a gap of £22.376 million remains for 2017-18. At the time of our audit, £4.713 million (18.45%) of the financial recovery actions were classified as high risk. There is no clear plan yet to close the remaining financial gap.

70. The financial plan for 2017-18 commits all of NHS Lothian's reserves flexibility. In addition, as highlighted below, the recurring financial gap is predicted to increase over each of the next 5 years (to £91.2 million in 2021-22). A failure to identify financial recovery plans beyond 2017-18 would increase the total gap to over £190 million by 2021-22. A medium term financial plan to deliver recurring financial balance is therefore a key priority for 2017-18.

71. NHS Lothian has recognised the significance of this financial risk within the Corporate Risk Register. The risk that the scale or quality of the Board's services is reduced in the future due to failure to respond to the financial challenge is monitored by the Finance and Resources Committee. The risk is currently rated as very high, and is above the Board's target risk level.

Management action plan point 1

The financial gap is estimated to reach £91.2 million by 2021-22.



Key assumptions and risks in the emerging financial plan

72. NHS Lothian recognises the increasing risk facing the Board in light of the recurring deficit. In May 2017, the Finance & Resources Committee received a paper on the development of a longer term financial strategy.

73. NHS Lothian assumes that there will be no uplift in baseline budget after 2017-18. The key, high-level financial assumptions used by NHS Lothian for 2017-18 and beyond are detailed in the table across:

74. These assumptions are broadly consistent with the rates applied by NHS Lothian in previous years, but the overall efficiency requirement remains higher than has been achieved in previous years

	Assumed uplift
Baseline budget uplift	0.0%
Pay awards (including National Insurance costs)	1.0%
Anticipated recurrent annual efficiency savings	£25m
Growth and commitments	£16m
Remaining NRAC in 2018-19	£12m

75. The paper presented to the Finance & Resources Committee outlined a programme to consider a baseline assessment of current service configuration, and what the “future state” should be. This will form the first stage of a significant service redesign programme to achieve both a sustainable financial and operational future.

Workforce planning is generally effective but NHS Lothian faces challenges in achieving sickness absence targets and given the ageing nature of its workforce

76. Within the recovery and efficiency actions delivered to date, NHS Lothian focused on four key workstreams:

- Acute medicines planning;
- Bed reduction planning;
- Reductions in the nursing cost base; and
- A waiting times strategy to reduce the use of external capacity.

77. Each of these workstreams has an impact on the Board’s workforce. The Finance Plan is underpinned by the Workforce Plan as over 50% of NHS Lothian’s annual budget is spent on pay.

78. NHS Lothian has created the Sustainable Workforce Programme Board to ensure any workforce models created during service redesign with health and social care partners will maintain a safe and effective workforce. The Programme Board also pursues a reduction in the use of agency nursing.

79. Audit Scotland’s early work on NHS Scotland’s workforce highlighted challenges for NHS Lothian, including:

- Sickness absence continues to exceed the 4% target (currently 4.89%)
- Staff turnover is significantly higher than the national average
- NHS Lothian continues to make greater use of agency consultants than the national average.

5

Governance & transparency

Governance & transparency

80. Governance and transparency is concerned with the adequacy of governance, leadership and decision making, and transparent reporting of financial and performance information. NHS Lothian 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.

Significant audit risk

81. As outlined in our audit plan, we considered there to be a significant risk to the wider scope of our audit in relation to governance and transparency:

Health & Social Care Integration

In addition to the financial reporting and consolidation challenges discussed previously, such a fundamental change in the way the “integration functions” are governed across Lothian mean success, sustainability and performance are now more than ever intrinsically linked to that of IJB and local authority partners. There is also a risk that the Board’s governance arrangements do not adequately or effectively reflect and/or support the changes to integrated functions following the formal delegation of responsibilities to the IJBs.

Overall conclusion

82. NHS Lothian has well developed governance arrangements in place. Our audit work has included reviewing the Board’s assurance arrangements as they relate to the corporate governance framework, the information provided to the Board and committees, and the risk management arrangements in place.

The Board has an effective Assurance Framework in place

83. NHS Lothian has developed an Assurance Framework for the Board and its main governance committees. Under the framework, papers to committees must conclude on the level of assurance that the report offers the committee:

- Significant
- Moderate
- Limited
- None
- Not yet assessed.

84. As part of the annual assessment of the governance framework - as used to inform the governance statement - each of the key committees report to the Audit and Risk Committee setting out the level of assurance they can provide against their remit.

85. The Committee provides a summary of the assurances it has received against its defined statement of assurance needs. The statement of assurance needs is drawn from the committee’s terms of reference. Within the report, each committee will identify any significant control weaknesses or issues which it considers should be disclosed in the Governance Statement. In addition, Executive Directors and the Chief Officers of the Integration Joint Boards provide a statement on their areas of responsibility.

86. We have concluded that these assurance arrangements are well-developed and focused on the needs of the Board and its committees.

Integration Joint Boards (IJBs)

87. NHS Lothian’s four IJBs became fully operational on 1st April 2016. Their role and the performance and scrutiny arrangements to support the IJBs continues to develop.

88. The Board’s key committees have used development days to consider the complexity of the governance arrangements and how each committee receives the assurance it needs on health and social care. The aim has been to secure the most efficient and effective joint working arrangements as the respective parties move towards business as usual.

Risk Management

89. A developed and integrated approach to risk management is a key feature of a robust system of internal control.
90. The corporate risk register is linked to NHS Lothian's corporate objectives. The Board receives regular reports on the corporate risk register, which provide updates action taken by the Risk Management Steering Group to mitigate risks. At the end of 2016-17, three risks were highlighted as very high risks that fall outwith the Board's appetite for those objectives:
- The scale or quality of the Board's services is reduced in the future due to failure to respond to the financial challenge
 - Achieving the 4-Hour Emergency Care standard
 - Achieving the Delayed Discharge targets at 2 and 4 weeks.
91. Whilst acknowledging NHS Lothian faces ongoing challenges and significant risks, we have concluded that risk management arrangements are satisfactory and appropriate.

Internal Audit

92. An effective internal audit service is an important element of NHS Lothian's governance arrangements. NHS Lothian has a compliant and appropriate internal audit service provided through a co-sourced arrangement with Grant Thornton.
93. During our audit we took cognisance of the work of internal audit to ensure the most efficient use of NHS Lothian's total audit resource. In particular we considered the findings of internal audit in relation to:
- Risk management;
 - Performance management;
 - Budget management and Financial Recovery Plan monitoring; and
 - Financial governance reviews relating to the Integrated Joint Boards.

94. At the start of 2016/17, Scott-Moncrieff staff were involved in the provision of NHS Lothian's internal audit service before arrangements were handed over to Grant Thornton. This issue was fully disclosed in advance to Audit Scotland before they made local audit appointments as part of the extant five year cycle. A controlled and managed transition plan was agreed to safeguard independence, with Audit Scotland fully involved in overseeing and approving these arrangements.

Standards of conduct

95. In our opinion, NHS Lothian's arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are generally adequate. Our conclusion has been informed by a review of the arrangements for adopting and reviewing standing orders, financial instructions and schemes of delegation and for complying with national and local codes of conduct.
96. We have also considered the controls in place to ensure compliance with the regulatory guidance that is produced by the SGHSCD throughout the year and identified no reportable issues.

Declarations of interest

97. Board members must declare financial and non-financial interests which might be perceived to influence their contribution to a discussion or decision in Board proceedings. In line with the Ethical Standards in Public Life etc. (Scotland) Act 2000, a register of members' interests is publically available on the Board's website.
98. We identified four non-financial interests which had not been disclosed in the register of interests during 2016/17; three charity trusteeships and one appointment resulting from another public sector role. We are not aware of any indication that there has been an actual conflict during the year in relation to these interests. However, to ensure that the Board is seen to avoid even the perception of conflict, all members' interests must be disclosed in full.

99. To support full disclosure, the Board should ensure that all relevant members and officers understand the full range of interests that must be declared and the timeliness of this disclosure.

Management action plan point 2

100. We also note that a former Board member was censured by the Standards Commission for Scotland in November 2016 for failing to declare an interest prior to a Board discussion.

The Role of Boards

101. In September 2010 the Auditor General for Scotland published a report aiming to assess the role and work of boards across 67 public bodies and 39 colleges. The report made various recommendations, as follows:

All non-executives should receive a formal induction	Boards should review the skills and expertise required on the Board and attract people to plug the gaps	Performance of non-executives should be assessed on a regular basis	Scrutiny efforts should be focused on organisational performance, financial and risk management
Performance information provided within reports could be improved	Boards should aim to maximise openness and accessibility of papers	Declarations of interest should be considered at every meeting	Boards should review the use of Committees and ensure delegation levels are appropriate

102. As part of our audit work in 2016/17 we followed up on NHS Lothian's response to the issues highlighted by Audit Scotland. Our aim was to identify any causes for concern or areas of good practice. This information will be submitted to Audit Scotland, who will assess the findings across the public sector in Scotland to identify any common issues.

103. We have noted as part of our work on the governance framework that arrangements for scrutiny and decision-making are deemed to be appropriate. We consider that the assurance framework provides a clear framework for reporting and scrutiny at committee level.

104. Appraisal arrangements are in place both for Executive and Non-Executive Directors. The Chair's performance is assessed by the Scottish Government.

105. The Chair of the Board meets with the Chairs of each governance committee on a monthly basis to ensure that key issues and challenges are shared and understood.

106. There is a programme of induction training for new board members and regular development days are held at board and committee level. As part of the annual assurance reporting to the Audit and Risk Committee, the Chair of each governance committee provides a statement confirming that the committee has reviewed its effectiveness, and whether or not the committee has concluded that it has effectively fulfilled its remit.

107. Recent improvements have been made to the quality of papers, using the assurance framework. A consent system is also in place at Board meetings to ensure that sufficient time is available to discuss areas for decisions, rather than reports for noting.

108. Overall, we have concluded that these arrangements provide an effective overall framework.

6

Value for Money

Value for money

109. Value for money is concerned with the appropriate use of resources and ensuring continuous improvement of services delivered.

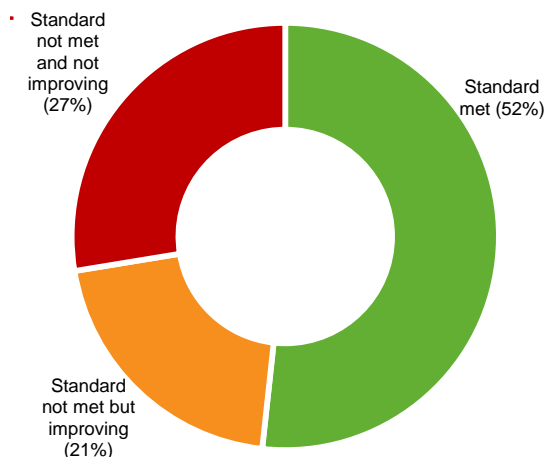
Overall conclusions

A well-established and appropriate performance management framework is in place

110. NHS Lothian's performance management arrangements support scrutiny and challenge, and help support and contribute to the achievement of value for money. The Board has appointed a Chief Quality Officer to drive improvement across the organisation, including in fostering an improvement culture.
111. Performance is reported on a monthly basis through the Corporate Management Team and Board in a Quality and Performance Improvement Report. The report summarises performance across a range of measures including targets and aligns each measure to the relevant governance committee responsible for scrutinising performance.
112. Exception reporting is used to ensure that the Board receives detailed explanations from the Director responsible on areas where performance is below target.

NHS Lothian has demonstrated improvement in performance against both prior year and target

113. NHS Lothian reported against 29 non-financial targets in 2016-17. A RAG rating is given to each indicator showing current performance and trend information across the financial year.
114. The graph below shows current performance for 2016/17 as reported to the Board in June 2017. 15 (52%) of the targets were met whilst eight (27%) were not met and are not improving.
115. Performance in 2016-17 generally exceeds the performance in 2015-16, where standards were met in only 12 measures. Key improvements include achieving the target for clostridium difficile infections.



116. The rate of delayed discharges continues to be a challenge for the Board and its social care partners, but improvements have been made in 2016-17.
117. The timeliness of receiving care continues to be a challenge against a number of expected standards:
- Only 51.4% of child and adolescent mental health patients were seen within 18 weeks of referral (target: 90%)
 - Only 79.7% of inpatient and daycases covered under the treatment time guarantee were seen within 12 weeks
 - 72.7% of outpatients waited less than 12 weeks (target: 95%)
 - Only 68.6% of psychological therapy patients were treated within 18 weeks (target: 90%)
 - 79.1% of patients were treated within 18 weeks of referral (target: 90%).

118. The Board had previously decided to stop using the independent sector for largely financial reasons. However, towards the end of 2016-17, NHS Lothian agreed to invest £6m in the use of the independent sector to help improve access waiting times for out-patients until the end of March 2017, whilst recognising this was using non-recurring money and did not offer a sustainable solution.

Clinical Quality Academy

119. In his report on 2016-17, the Chief Executive acknowledges the capacity risk facing the leadership team is how to address the twin challenges of growth in demand and reduction in resources, alongside the more complex organisational landscape.

120. In April 2016, the Board appointed a Chief Quality Officer, to lead the work to create an enhanced whole organisation approach to quality assurance and improvement, and to ensure that quality remains a key focus during a period of transformation.

121. The Board has also created the Clinical Quality Academy to build and support the understanding, capability and capacity of NHS Lothian staff in aspects of quality planning, improvement and control of processes relating to health and care.

122. The Academy aims to develop understanding and application of the following themes:

- Quality Improvement theory and Practice
- Technical Skills with Data, Measurement, Visualisation and Reporting
- Application of Innovation, Redesign and Systems Thinking
- Human Factors and Safety Science and Teamwork
- Awareness of self and Leadership of others

123. The Academy will drive priority clinical quality programmes to improve outcomes in both primary and secondary care. The programmes currently focus on improving outcomes in mental health, stroke disease, cancer, outpatient endoscopy and hip fractures. NHS Lothian reports that as a result of the delivery model significant, sustained improvements have been achieved, alongside a high level of staff engagement.

124. We will continue to monitor these developments into 2017/18 and beyond.

7

Appendices

Appendix 1: Management action plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during our audit.

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. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist. The weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist.

Communication of the 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.

Action plan grading structure

To assist NHS Lothian in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised 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. Financial sustainability	<p>Observation A medium term financial strategy is essential to demonstrate how financial sustainability can be achieved.</p> <p>The Board faces a significant recurring deficit position in the period to 2021-22, with no clear and detailed plans yet in place to bridge the financial gap.</p> <p>Recommendation The Board should continue to work with its partners to identify a clear approach to financial sustainability over the medium term.</p>	<p>Action owner: Susan Goldsmith</p> <p>Due Date: Ongoing</p> <p>The Board recognises the critical importance of its financial planning strategy and will continue to work with all relevant partners.</p>
Rating		
Grade 4		
Paragraph ref		
70		

Action plan point	Issue & Recommendation	Management Comments
2. Declarations of interest	<p>Observation We identified four non-financial interests which had not been disclosed in the register of interests during 2016/17; three charity trusteeships and one appointment resulting from another public sector role.</p> <p>We are not aware of any indication that there has been an actual conflict during the year in relation to these interests.</p> <p>Recommendation To ensure that the Board is seen to avoid even the perception of a conflict of interests, all members' interests must be disclosed in full. To support full disclosure the Board should ensure that all relevant members and officers understand the full range of interests that must be declared and the timeliness of this disclosure.</p>	<p>Action owner: Douglas Weir</p> <p>Due Date 31 July 2017</p> <p>A detailed section on Declaration of Interest will be included in the Interactive Board Member Induction pack being updated and prepared for new Board Members. The cover letter will draw specific attention to requirements around declaration of interest. The Induction pack will be issued to existing as well as new Board Members. Issues around declaration of interest will also be covered in the more formal Induction process that is being prepared for new Board Members.</p>
Rating		
Grade 3		
Paragraph ref		
99		

Appendix 2: Respective responsibilities of the Board and the Auditor

Responsibility for the preparation of the annual report and accounts

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;
 - make judgements and estimates on a reasonable basis;
 - state whether applicable accounting standards as set out in the Financial Reporting Manual have not been followed where the effect of the departure is material;
 - prepare the accounts on a going concern basis unless it is inappropriate to presume that the Board will continue to operate; and
 - ensure the regularity of expenditure and income.
- 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:

- 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 2017 and of its net expenditure for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 FReM ;
- have been prepared in accordance with the requirements of the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers;
- in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers;
- the auditable part of the Remuneration and Staff Report 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 financial statements are prepared is consistent with the financial statements and that report has been 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 Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the National Health Service (Scotland) Act 1978 and directions made thereunder by the Scottish Ministers.

We are also required to report by exception 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
- there has been a failure to achieve a prescribed financial objective.

Wider scope of audit

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, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

The Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we will consider and report against these four dimensions: financial management; financial sustainability; governance and transparency; and value for money.

Independence

We are required by International Standards on Auditing to communicate on a timely basis all facts and matters that may have a bearing on our independence. We can confirm that we have complied with the Financial Reporting Council's Ethical Standard. In our professional judgement the audit process has been independent and our objectivity has not been compromised. In particular, there have been no relationships between Scott-Moncrieff and the Board or senior management that may reasonably be thought to bear on our objectivity and independence. This conclusion has been reached after consultation with Audit Scotland in relation to audit transition issues, to provide third party oversight and approval to this area.



Scott-Moncrieff
business advisers and accountants

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