

Public Sector Assurance

16 June 2011

# NHS Education for Scotland Annual Report to Board Members and the Auditor General for Scotland 2010/11



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The principal objective of our audit procedures is to enable us to express our opinion, in line with the requirements of the Audit Scotland Code of Audit Practice, on the financial statements as a whole. Our audit opinion does not guarantee that the financial statements are free from misstatement. Our audit responsibilities, and their limitations are explained in our letter of appointment.

Any oral comments made in discussions with you relating to this report are not intended to have any greater significance than explanations of matters contained in the report. Any oral comments that we make do not constitute oral advice unless we confirm any such advice formally in writing.

The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks at NES or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

# 1. Executive Commentary

## Introduction – Section 2

Our overall responsibility as external auditor of NHS Education for Scotland (NES) is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice (“the Code”), revised and published in March 2007.

We have a dual reporting responsibility for the audit: to the Board Members of NES and to the Auditor General for Scotland.

## Financial Statement and Audit Opinions – Section 3

The financial statements of NES for the year ended 31 March 2011 have been prepared to comply with accounting requirements contained in the NHS Board Accounts Manual for Directors’ Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

We are pleased to report that our **true and fair opinion** and **regularity opinion** on the financial statements for the year ended 31 March 2011 are **unqualified**.

We also provide a view as to whether those parts of the Remuneration Report subject to audit have been properly prepared. Our opinion on the relevant parts of the **Remuneration Report is unqualified**. It should be noted that our audit opinion does not extend to other parts of the Annual Report.

## *Basis of Preparation – International Financial Reporting Standards*

Government bodies, including NHS Boards, were required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. The objective was to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting. Reporting under IFRS is ‘business as usual’ for the year 2010/11 onwards.

## Accounting Issues

A number of accounting issues were discussed with management during the audit. The most significant of these are set out below:

- Assessment of going concern – net liability position;
- Investigation of outdated cheques;
- Staff expense claims; and
- Disclosure of Defined Benefit Surplus Position

## Financial Performance 2010/11 – Section 4

NES is required to meet five targets each year as set by the Scottish Government Health Directorate (SGHD). All five of these targets were achieved in the year including the new targets relating to non-core expenditure.

## Governance and Performance 2010/11 – Section 5

We have reviewed NES's overall governance arrangements including a review of significant changes to directorate structures, issues reported by Healthcare Improvement Scotland and gaps in risk management. We have also considered arrangements with partnership working; service sustainability; financial management and performance and people management. We have reviewed NES's overall systems of internal control including a review of IT general controls (ITGC); the National Fraud Initiative; and internal audit arrangements.

## 2. Introduction

### Purpose of this report

The Annual Audit Report which follows is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically this will direct your attention to matters of significance which have arisen out of the 2010/11 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

### Scope, nature and extent of our audit

Our overall responsibility as external auditor of NES is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in March 2007. In this regard, the Code sets out the need for public sector audits to be planned and undertaken from a wider perspective than in the private sector involving not only assurance on the financial statements but also consideration of areas such as regularity, propriety, performance and the use of resources. It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving the "appointed auditor", the Auditor General for Scotland and other auditors such as Audit Scotland's Health Performance and Public Reporting Group. Our audit has been planned and conducted to take account of these wider perspectives. Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260: "*Communication of audit matters to those charged with governance*", we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This Annual Audit Report to Members, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

### Acknowledgment

We would like to formally extend our thanks to all NES managers and staff for the assistance they have given us during the current year's audit process and to thank them for the courtesy and cooperation extended to us throughout our tenure as external auditors which now concludes.



**PricewaterhouseCoopers LLP**  
Glasgow, 16 June 2011

## 3. Financial Statement and Audit Opinion

### Audit opinion

Our audit opinion concerns both the true and fair statement of NES's financial results for the year ended 31 March 2011 and the regularity of its income and expenditure for the year.

We are pleased to report that our opinion on the true and fair view on the financial statements and on the regularity of income and expenditure is **unqualified**.

We also provide a view as to whether those parts of the Remuneration Report subject to audit have been properly prepared. Our opinion on the Remuneration Report is **unqualified**. Our audit opinion does not extend to any other part of the Directors' Report.

### Audit Process

The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided by management was of a high standard. Overall an efficient audit process was achieved through an effective working relationship with your staff.

### Basis of Preparation

The financial statements were prepared in accordance with the accounting requirements contained in the NHS Board Accounts Manual for Directors' Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

Government bodies, including NHS Boards, have been required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. The objective was to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting. Reporting under IFRS is 'business as usual' for the year 2010/11 onwards.

### Approval

The Financial Statements are submitted to NES's Audit Committee on 16 June 2011 and are to be approved and adopted at the Board meeting on 23 June 2011.

## Unadjusted misstatements

Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those which we deem to be of a trivial nature. As a result of our work, we proposed a number of audit adjustments and all of these have been processed by management in the finalised version of the 2010/11 financial statements. We, therefore, have no unadjusted 2010/11 misstatements to report.

## Accounting Issues

### Going Concern

NES is currently disclosing total net liabilities of £17,149 million on its balance sheet as at 31 March 2011 (2010: £14,384 million) meaning that it is technically insolvent. Under the current accounting arrangements as set out in the Financial Reporting Manual (FReM) NES must show liabilities on its balance sheet without drawing down the equivalent cash to fund them. However, as these liabilities fall due, the cash will be requested from the SGHD to meet the payments.

We are satisfied that the accounts have been correctly prepared on a going concern basis.

### Investigation of Outdated Cheques

We are pleased to report that the previously reported issue around the automated bank reconciliation module was resolved during 2010/11 and the Finance team are no longer required to perform manual reconciliations. However we noted a further control issue in relation to bank reconciliations during our final visit.

During our testing of bank reconciliations we noted that the Citibank account reconciliation had 340 outstanding cheques which had not cleared the bank account by the year end. Further investigation revealed that 200 of these outstanding cheques, totalling £45,672, were older than 6 months with some dating back to October 2008. The majority relate to expenses paid to trainee doctors to reimburse travel and subsistence costs; however there were 20 cheques issued to suppliers that were not cashed and still shown as outstanding on the list of reconciling items.

*We recommend that management investigate all outstanding cheques older than 6 months on the outstanding cheque list in order to identify the reason, so that these can be treated appropriately in the accounting records. Once the initial review is completed, management should delegate responsibility to an appropriate member of staff to review all outstanding cheques older than 6 months on a monthly basis as part of the monthly bank reconciliation process so that the number of long outstanding cheques stays within a manageable level.*

*Action 1*

## Staff Expense Claims

We are required to incorporate an element of unpredictability within our audit approach to address the risk of possible fraud. During our 2010/11 audit, we tested the controls in place around staff expense claims during our final audit visit in order to validate that expense claims were processed in accordance with the staff expense claim policy. Our testing included a selection of 30 staff expense claims and we verified that:

- The claim had supporting backup and constituted valid expenditure within agreed thresholds;
- The amount refunded to the claimant agreed to supporting receipts provided; and
- The claim was authorised by a designated staff member.

We noted three exceptions: Two claims were authorised by a staff member who was not the claimant's line manager. We also noticed one instance where the claimant was refunded for accommodation at £135 per night, while the maximum allowance is £110 per night. We acknowledge that staff authorising claims have discretion to allow claims higher than the maximum allowance, however, no backup was attached to the claim to justify that the claim amount was reasonable under the circumstances.

*We recommend that the Payroll team review and update the staff expenses policy to make it clear that any manager can authorise expense claims, even if it is not the claimant's line manager. Furthermore, staff authorising expense claims should be reminded that additional evidence should be attached to claims when thresholds are exceeded in order to justify the expense incurred as reasonable.*

### Action 2

## Defined Benefit Surplus Position

Former employees of the National Education for Scotland, whose activities were transferred to the organisation on 1 April 2002, were previously members of the FPS 1654 Pension Scheme. The FPS 1654 Scheme operates a closed defined benefit scheme in the UK and provides retirement benefits based upon final salaries. For the past few years NES has had a net deficit pension position with its benefits obligation exceeding the value of its attributable pension asset. The net obligation was disclosed within provisions in the financial statements. NES reported a defined benefit obligation of £0.371 million as at 31 March 2010. However as at 31 March 2011 the value of pension assets exceeded the benefit obligation giving a surplus of £0.557 million.

The pension surplus position is attributable to a number of factors, but the main reasons include a payment made by NES of £0.37 million to address the deficit at 31 March 2010 and an increase in the expected return on assets to 5.15%.

NES had originally included the pension surplus of £0.557 million as part of provisions, as in prior years, with the debit balance being deducted from the other credit provision balances. However it was clarified through discussions with the actuary that because the scheme is closed and NES has no future employer contributions against which to offset the surplus, the surplus cannot be recovered and, therefore, cannot be recognised as an asset by NES. In response, we agreed, following actuarial advice with an adjustment that was subsequently amended by management to write off the surplus through the Statement of Changes in Taxpayers' Equity against the General Fund, in accordance with the requirements of IAS 19, as the existence of an asset at the balance sheet date depends on whether NES has the right to obtain a refund or a reduction in future contributions. Neither applies and, therefore, an asset cannot be recognised.



## 4. 2010/11 Performance

### Financial Results 2010/11

2010/11 Outturn	£'000	£'000
Recurring income	420,433	
Recurring expenditure (before savings)	(419,115)	
Recurring underspend (before savings)	1,318	
Recurring efficiency savings	<u>2,244</u>	
<b>Underlying recurring surplus / (deficit)</b>		<b>3,562</b>
Non-recurring income	8,153	
Non-recurring expenditure (before savings)	(5,828)	
Non-recurring underspend (before savings)	<u>2,325</u>	
Non-recurring efficiency savings	<u>0</u>	
<b>Non-recurring surplus/(deficit)</b>		<b>2,325</b>
<b>Financial surplus/(deficit) for the year</b>		<b>5,887</b>
<b>Underlying recurring surplus / deficit as a percentage of recurring income</b>		<b>0.85%</b>

Figures confirmed by Audrey McColl, Deputy Director of Finance

The actual out-turn for the year is an underspend of £5.9 million against a planned underspend of £5.2 million. The main reason for the variance between planned and actual underspend is the change in treatment of provisions. The underspend carried forward into 2011/12 is limited to the forecasted underspend of £5.2 million.

NES anticipated that new provisions of £0.882 would be charged to their core RRL expenditure; however the Scottish Government Health Directorate (SGHD) advised during the year that provisions will instead be charged to non-core RRL expenditure. The actual under spend would therefore have been £5 million had this change in treatment not occurred.

The table provides an analysis of NES's 2010/11 final outturn position of £5.9 million. The under spend can be allocated as follows:

- Dental - £1.1 million;
- Audiology - £0.53 million;
- Healthcare Scientist - £0.757 million; and
- NMAHP projects - £0.716 million.
- Other areas - £2.797 million

Further detail on the reasons for directorate under spends are provided overleaf.

## Budget Variations

A number of directorates have reported an underspend during the year and we have summarised the key reasons below:

### *Dental*

The under spend on the dental budget is £1.1 million which is mainly attributable to trainee vacancies (£575k), unutilised Childsmile funding (£291k), slippage and vacancies in Dental Care Practitioner training (£153k), Trainer Development course recharged to SGHD (£94k) slippage on Dental Action Plan including CLEO project (£94k) and unutilised Section 63 funding (£90k). This was offset by significant over spends on the Digital Design Studio project of £145k due to the unbudgeted increase in VAT costs and Outreach centres of £144k due to additional funding commitments.

### *Audiology*

The yearend outturn of £530k under spend was as budgeted. NES have negotiated with the Queen Margaret University the amount of funding that will be available to run the Audiology course over the final two years of the agreement with a final payment being due in 2011-12.

### *Healthcare Scientists (HCS)*

The under spend on this budget is a result of slippage on projects and in the delayed recruitment to training schemes. The final outturn figure of £757k is £211k higher than originally forecast. This difference has arisen as a result of the late notification from NHS Tayside of Higher Specialist Training vacancies; and Pre-Registration Genetics costs being lower than forecasted.

### *NMAHP*

The following projects did not meet the expenditure levels forecast by a significant margin: National Strands (£91k), Early Clinical Career Fellowships (£82k), Recruitment and Retention (£54k) and Physician Assistants – Anaesthesia (£38k). Two projects had year-end accruals from 2009-10 that were not re-accrued this year amounting to £70k. There was further slippage on general costs and additional income contributing a further £74k to the final outturn position.

### *Other Areas*

The under spend of £431k in the South East region is mainly a result of training grade vacancies, due to flexible trainees (£290k) and non uptake of study leave (£145k). The main cause of the final under spend of £267k in GP Medical is slippage on the consultant appraisal project amounting to £86k. The various trainee budgets are £129k under spent due to lower travel and subsistence and vacancies than originally budgeted.

The budget under spend of £320k in Hospital Medical is due to a number of factors. The most significant of these are: training grade vacancies amounting to

£79k; Medical Act income of £70k, unutilised Educational Governance and MMC funding is £66k and £44k respectively and current staff vacancies contribute a further £38k to the final outturn position.

## Performance against Key Financial Targets

NES is required to meet five targets each year as set by the Scottish Government Health Directorate (SGHD). NES has achieved all five of its financial targets in the year, as follows:

	Limit set by SGHD £'m	Actual Outturn £'m	Variance (over)/under £'m
Revenue Resource Limit - Core	427.078	421.197	5.881
Revenue Resource Limit – Non - Core	1.508	1.502	0.06
Capital Resource Limit - Core	1.552	1.493	29
Capital Resource Limit – Non - Core	0	0	0
Cash Requirement	420.000	419.397	0.603

### *Non-Core Expenditure*

The responsibility of a board to deliver a balanced outturn in year relates to the total allocation, including core and non-core elements. The expenditure recorded in the monthly monitoring return against these allocations will be used to assess each board's financial position and key risks and assumptions during the course of the year. NES had the opportunity to amend the allocations until the end of November 2010, when a final forecast was submitted.

## Performance Monitoring

### **Key Performance Indicators**

NES has a Local Delivery Plan agreed with the Scottish Government Health Directorate. This contains a number of targets structured under four key Ministerial Objectives which are common across NHS Scotland:

- Health Improvement for the people of Scotland – improving life expectancy and healthy life expectancy.
- Efficiency and Governance Improvements – continually improve the efficiency and effectiveness of the NHS.

- Access to Services – recognising patients need for quicker and easier use of NHS services.
- Treatment Appropriate to Individuals: ensure patients receive high quality services that meet their needs.

At the end of the year, one sub-target within Health Improvement for the people of Scotland relating to the creation of a health behaviour change on-line portal was not met. It was decided that the format of this project was no longer appropriate for the current context and the planned outcome was achieved by other means. Another sub-target within Access to Services relating to the building capacity and capability in Applied Psychology and Psychological Therapies was not met. This service related to the provision of a Psychology programme for staff dealing with health improvement and long term conditions which was discontinued in the light of the financial downturn. NES met all other targets structured under the key Ministerial Objectives.

NES has a number of strategic and operational performance measures in addition to the Ministerial Objective targets which are recorded on the performance management system. The performance management system is based on a dashboard reporting tool which allows performance information to be captured and monitored against key performance measures at every level of the organisation. This includes information on NES' performance against both its overall strategic objectives and its performance against its Local Delivery Plan and associated HEAT targets.

The Finance & Performance Management Committee reviews full performance reports generated by the dashboard system on a quarterly basis. Each directorate has established an operational plan which includes key objectives and performance indicators. The individual directorates are responsible for updating the performance dashboard, with targets assigned to specific individuals within the unit as a performance owner. Each of these individuals meets with the performance improvement officer on an annual basis. Training courses for staff on the functionality of the dashboard reporting tool are held as and when they are deemed necessary.

### **Sickness Absence**

The Board has a pro-active policy on the management of sickness absence and the absence rate improved during 2010/11 to 2.84% compared to 2.94% in 2009/10.

## 5. Governance and Control

### Overall Governance Arrangements

NES has a well established integrated governance framework in place, with the Board supported by Audit, Staff Governance, Remuneration, and the Finance & Performance Management Committees. In the current year, the Educational Governance and Education Research Governance committees merged. Further support is provided by the Partnership Forum and the Business Group. The Audit Committee receives an annual report from each of the standing committees as a means to provide assurance that the Committee has discharged its responsibilities effectively throughout the year. Such assurance is provided to the Board by the Audit Committee annually.

It is our understanding and experience that the non-executive committee members participate actively in both Board and Committee meetings.

NHS QIS reported their findings from the November 2009 Clinical Governance and Risk Management (CGRM) peer review in early 2010. The results were positive with NES exceeding the performance targets it had set following its previous NHS QIS review. Healthcare Improvement Scotland (HIS) replaced NHS QIS in April 2011. It is not yet clear what the approach of HIS to CGRM review will be.

### Service Sustainability

NES had previously identified the need for flexibility in meeting the challenges of the economic downturn, as well as the requirement to support the delivery of safe and effective people centred services which are closer to home and involve patients and carers in decision making. The Strategic Plan for 2011-2014 was officially launched in January 2011. The plan has been developed over the past year incorporating the priorities of key contacts within other NHS Scotland Boards and was released for wider consultation during the summer of 2010.

Following detailed discussion by the Business Group and agreement in partnership during January 2011, NES, in common with other NHS Boards, had submitted baseline information to Scottish Government Health Directorate in relation to reducing its senior management numbers by 25% over the five-year period to 2014/15.

### National Performance Audits

At the request of Audit Scotland, we were required to perform targeted follow up work on one of their National Performance Reports: Improving public sector purchasing (published July 2009). The 2011 Procurement Capability Assessment (PCA) undertaken by National Procurement defines NES as 'conformant' i.e.

within an acceptable range and only 3% away from being scored as 'improved'. The results of our follow up work suggest that NES have made reasonable progress to implement the recommendations proposed by National Procurement. The results of our work have been reported to the Audit Committee in a separate report entitled Procurement Follow Up Report 2010/11.

#### People Management – pay modernisation

NHS Boards are to ensure at least 80% of staff covered by Agenda for Change has their annual Knowledge and Skills Framework development reviews completed and recorded on e-KSF by March 2011. NES successfully achieved 86% of staff covered by Agenda for Change having their annual KSF development reviews completed and recorded on e-KSF as per the LDP target of March 2011.

#### People Management – equal pay

NES is committed to equal pay and has published an Equal Pay Statement on its extranet. The risk of non-compliance with the Equal Pay Act is included in the NES global risk register and measures have been put in place to ensure compliance - including an equal pay audit. NES is required to review and report on its equal pay statement every 3 years with a formal review conducted during September 2010. NES currently has no equal pay claims pending.

#### Review of staff earning over £100,000 per annum

In December 2010 guidance was issued to Directors of Finance in the Public Sector relating to the Cabinet Secretary's letter to all Board Chairs on 12 November 2010 requesting a detailed review of staff earning over £100,000 per annum. External audit conducted the review in March 2011 of all employees' paid over £100,000 per annum and they checked all the individual files to ensure that amounts paid to the relevant employees were in compliance with national pay policies and circulars. No exceptions were noted and external audit reported that NES was in compliance with the national policies and circulars.

#### Systems of Internal Control

The results of our work on systems of internal control were communicated to Audit Committee in our Interim Management Letter on 7 April 2011. The report contained 16 recommendations to improve controls. One recommendation relating to improved control over journal processing was graded as high risk and is now implemented. There were also no risks identified that could be considered business critical in nature. NES has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. The new appointed auditors will follow up the action plan during the 2011/12 audit process.

#### Statement on Internal Control

The Code of Audit Practice requires us to review and report on NES's Statement on Internal Control. NES has used the correct format for its Statement and has outlined the processes it has employed to identify and evaluate risks. In addition, key elements of NES's control framework have been highlighted. Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

## Follow up of outstanding recommendations

We followed up NES's progress in implementing recommendations made in the prior year. Our Follow Up of prior year recommendations was included in the Interim Management Letter considered at the Audit Committee meeting on 7 April 2011. At the time of reporting, of the 16 agreed actions, progress was as follows:

Status	Interim Management Report 2009/10	Annual Report to Members 2009/10	Total
Action Implemented	8	1	9
Action in Progress	2	-	2
Not Yet Due	4	-	4
No Longer Applicable	1	-	1
<b>Total</b>	<b>15</b>	<b>1</b>	<b>16</b>

Please refer to appendix B and C of this report for further detail about the actions implemented, actions in progress and actions not yet due.

## Information Management

ISA (UK&I) 315.93 requires auditors to "... obtain an understanding of how the entity has responded to risks arising from IT". IT General Controls (ITGCs) are controls put in place by management to mitigate those risks. ITGCs help ensure the continued proper operation of information systems to maintain the integrity of information and security of data.

The IM&T directorate collated an Information Communications Technology (ICT) Strategy for the period 2011-2014 which was approved by the Board on 21 April 2011. The four main sections of the paper covered the current position; the strategic context; strategic principles; and financial implications. It was noted that this strategy was the first attempt to address the entire scope of NES ICT systems.

Particular attention was drawn to the three Strategic Priorities, which sought to address:

- A corporate approach to the further development of a number of NES systems designed to administer training and education;
- An approach to the development and support of NES e-learning materials; and
- Continued development of NES's underpinning ICT infrastructure.

NES is currently in the process of implementing an updated IM&T business continuity plan, which will be brought into the wider periodic testing of the NES business continuity and disaster recovery plans. The planned implementation date for the programme is 30 June 2011.

As part of our review of ITGCs we have performed testing on a sample basis, enabling us to gain comfort in this area. No weaknesses were identified that are deemed to have a material impact on the financial statements.

### Internal audit

The role of internal audit is determined by management and therefore its objectives differ from those of the external auditors. It is part of our approach to gain an understanding of the internal audit function to determine if it would be effective and efficient to use their work.

Scott Moncrieff replaced RSM Tenon (changed name during 2009/10) as internal auditors during 2010/11. We have reviewed the work of internal audit and have, where appropriate, placed reliance on their work eliminating duplication of effort.

### National Fraud Initiative

The National Fraud Initiative (NFI) brings together data from health bodies, councils, police and fire rescue bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. The 2008/09 NFI project was a 2 year initiative which was completed and a report issued by Audit Scotland in May 2010. NFI prescribes that public sector bodies are required to submit additional datasets on a risk-based approach. Management chose to submit the creditors dataset in 2010/11 as well as the mandatory payroll dataset because the new creditor system was implemented during 2010/11.

The initiative identified thirty six high risk matches, three relating to payroll-to-payroll and thirty three to creditor-to-payroll. The three payroll-to-payroll matches were investigated, however the creditor-to-payroll matches still required investigation at the time of our final audit visit. Management does not consider the creditor-to-payroll matches to be high risk from a NES perspective; however they intend to investigate them by the end of July 2011. No instances of fraud were identified at the time of our audit.

We noticed during our review of NES's NFI arrangements that no reference is made about NFI in the Fraud & Corruption policy located on the staff intranet. In addition to that, we could not find evidence that progress with the NFI initiative was reported at management meetings during the process. *We recommend that management update the Fraud & Corruption policy and include NFI arrangements in order to demonstrate that it forms an integral part of the body's corporate policies and strategies for preventing and detecting fraud and error. Management should also ensure that they obtain progress feedback from the NFI contact at least on a 6 monthly basis and the feedback should be documented in the minutes of the relevant meeting.*

*Action 3*



**Forecast Budget 2011/12**

<b>2011/12 Budget</b>	<b>£'000</b>	<b>£'000</b>
Recurring income	420,913	
Recurring expenditure (before savings)	(428,273)	
Recurring overspend (before savings)	(7,360)	
Recurring efficiency savings	<u>9,743</u>	
<b>Underlying recurring surplus / (deficit)</b>		<b>2,383</b>
Non-recurring income	2,959	
Non-recurring expenditure (before savings)	(6,099)	
Non-recurring overspend (before savings)	(3,140)	
Non-recurring efficiency savings	<u>(2,257)</u>	
<b>Non-recurring surplus/(deficit)</b>		<b>(883)</b>
<b>Financial surplus/(deficit) for the year</b>		<b>1,500</b>
<b>Underlying recurring surplus / deficit as a percentage of recurring income</b>		<b>0.57%</b>

Figures confirmed by Audrey McColl, Deputy Director of Finance

The approved financial plan for NES includes a carry forward into 2011/12 of £5.2 million. Of this, £3 million is ring-fenced for specific projects, which leaves a balance of £2.2 million in general carry forward.

NES propose to set £1 million of this amount against the total budget gap and to utilise the balance to create some flexibility to allow them to plan to carry forward £1 million into 2012/13. It should be recognised that this funding is non-recurring and therefore during the course of 2011/12 NES will need to identify an additional £1.2 million of recurring savings to balance the position as they move into 2012/13.

*Action 4*

**Cost Pressures**

Pay pressures provided for include: the cost to NES of incremental drift, the cost of applying the employers NICs increase (including to Training Grade Salaries), and pressures arising from the conversion of FTSTA posts to ST posts. It should be noted that managing these cost pressures has added a further cost pressure equivalent to around 0.8% of NES's total budget.

Specific provisions amount to 0.5% of the NES total budget and include: cover for double running, cost pressures arising from the increase in VAT and a provision for the savings anticipated from the Medical Defence Union costs, this final provision will be released dependent on negotiations between NES, CNORIS and the BMA relating to cover for GPSTs once they are in the employment of NES.

## Appendix A – Action Plan

Recommendation and Risk Rating	Management Response, Responsible Officer and Implementation Date
<p><b>Action 1</b></p> <p>Investigation of the outstanding cheque list revealed that approximately 200 of the outstanding cheques, totalling £45,672, were older than 6 months with some dating back to October 2008. We recommend that management investigate all the current outstanding cheques older than 6 months on the list in order to identify the reason, so that outstanding cheques are treated appropriately in the accounting records.</p> <p>Once the initial review is complete, management should delegate responsibility to an appropriate member of staff to review all outstanding cheques older than 6 months on a monthly basis as part of the monthly bank reconciliation process to ensure that the number of long outstanding cheques stays within a manageable level.</p> <p><b>Risk Rating – Medium</b></p>	<p><b>Management Response</b></p> <p>The initial review has been carried out. Of the 340 cheques outstanding 225 (£9,631) will be cancelled and written back. The remainder are still being investigated.</p> <p>As part of the monthly bank reconciliation process the Financial Services Manager will ensure that the processes required in the system to write back and cancel a cheque are actioned.</p> <p><b>Responsible Officer:</b> Head of Financial Services</p> <p><b>Implementation Date:</b> August 2011</p>
<p><b>Action 2</b></p> <p>We recommend that the Payroll team reviews and updates the staff expenses policy to make it clear that any manager can authorise expense claims, even if it is not the claimant's line manager, because line managers are not always available to authorise expense claims.</p> <p>Also, staff authorising expense claims, should be reminded that additional evidence must be attached to claims when thresholds are exceeded in order to justify the expense incurred is reasonable.</p> <p><b>Risk Rating – Low</b></p>	<p><b>Management Response</b></p> <p>The e-Expenses system has 2 authorisers set-up against each pay point allowing the next layer of line management to authorise an expense claim. The Policy will be updated to reflect this.</p> <p>All staff authorising expenses will be reminded of the requirement for additional proof in these circumstances.</p> <p><b>Responsible Officer:</b> Head of Financial Services</p> <p><b>Implementation Date:</b> June 2011</p>

Recommendation and Risk Rating	Management Response, Responsible Officer and Implementation Date
<p><b>Action 3</b></p> <p>We recommend that management update the Fraud &amp; Corruption policy to include NFI arrangements in order to demonstrate that this forms an integral part of the body's corporate policies and strategies for preventing and detecting fraud and error.</p> <p>Management should also ensure that a progress update is sought from the NFI contact on at least a 6 monthly basis and this update should be documented in the minutes of the relevant meeting.</p> <p><b>Risk Rating – Low</b></p>	<p><b>Management Response</b></p> <p>Agreed. The timescale is to allow for approval process via the audit committee.</p> <p><b>Responsible Officer:</b> Director of Finance and Corporate Resources</p> <p><b>Implementation Date:</b> October 2011</p>
<p><b>Action 4</b></p> <p>NES Management propose to set £1 million of the general carry forward amount for 2011/12 of £2.2 million against the total budget gap and to utilise the balance to create some flexibility to allow them to plan to carry forward £1 million into 2012/13.</p> <p>It should be recognised that this funding is non-recurrent and therefore during the course of 2011/12 an additional £1.2 million of recurrent savings must be identified to balance the position as NES move into 2012/13.</p> <p><b>Risk Rating – High</b></p>	<p><b>Management Response</b></p> <p>Management are well aware of the need to identify additional savings to support this element of the budget. The Chief Executive referred to this in his recent round of 'all staff' meetings so all staff are also aware of the target. The implementation of Activity Based Costing across NES together with a detailed review of operational plans are just two actions that are being taken to identify additional recurrent savings.</p> <p><b>Responsible Officer:</b> Director of Finance and Corporate Resources</p> <p><b>Implementation Date:</b> December 2011</p>

## Appendix B – Follow Up of Interim Management Letter 2010/11

Original Recommendation	Implementation Status:					Appendix Reference
	Action Implemented	Action in Progress	Little to Date	Not due yet	No longer applicable	
NES should formally assess itself against each question raised in the combined Audit Scotland, the NI Audit Office and the Wales Audit office detailed good practice checklist.						N/A
NES should ensure that all bank reconciliations are completed and reviewed in a timely manner before the financial year end. All bank reconciliations should be documented and reviewed on the standard reconciliations forms within one month of period end.						N/A
Expense payments should be processed only on receipt of an authorised expense claim form with appropriate supporting receipts attached.						N/A
NES should investigate any instances where an incorrect payment has been made and consider retrieving unsupported amounts from the employee.						N/A
All payroll reconciliations should be signed and dated as reviewed to evidence that they have been completed and all reconciling items followed up on a timely basis. This should be within one month of the period end.						N/A
All new suppliers who wish to be paid by BACS must supply supporting documentation confirming the bank details that appear on the 'new supplier' form. These should be attached to the New supplier form.						N/A

Original Recommendation	Implementation Status:					Appendix Reference
	Action Implemented	Action in Progress	Little Action to Date	Not due yet	No longer applicable	
All new supplier forms should be marked as checked and then authorised by another member of Finance to ensure adequate segregation of duties in the update of new suppliers.						N/A
NES staff should ensure that all study leave claims submitted should clearly be evidenced as prepared and authorised by two separate officers to ensure adequate segregation of duties in the payments.						N/A
A clear definition of key suppliers should be agreed by NES the statements of those categorised as such reconciled on a monthly basis. The supplier reconciliations should be performed both from the statements received to NES records and from NES records to the supplier statements to ensure that all items are correctly reconciled.						1.01
All invoices submitted for payment should be checked by a member of the Finance team to ensure that authorisation is given in line with delegated authority limits.						N/A
Written procedures for the processing of journals should be finalised as soon as possible and appropriate authorisation and retention of supporting documentation included in the final revised procedures.						N/A
The I&MT business continuity plan should be updated and brought into the wider periodic testing of NES business continuity and disaster recovery plans.						N/A
A management reporting system should be implemented to monitor ICT performance, providing comparative data for similar organisations where possible.						N/A

Original Recommendation	Implementation Status:					Appendix Reference
	Action Implemented	Action in Progress	in Little Action to Date	Not due yet	No longer applicable	
A data Quality framework based on the Audit Commission Data Quality Standards including the provision for peer and independent checking of data quality on key corporate systems should be implemented as soon as possible						N/A
NES should clearly define what its key information sets are and capture the costs of producing this information.						N/A
Full implementation of agreed HR service standards should be rolled out with reports being provided to senior management on a regular basis to inform workforce planning.						1.02

## Appendix C – Actions Outstanding from Interim Management Letter 2010/11

	Action Outstanding	Management Response	Responsibility	Date of Implementation
1.01	The procurement manager is currently performing a review to determine which suppliers are strategic suppliers of NES in order to identify the suppliers from whom a supplier statement is required.	To note that reconciliation of supplier statements is already in place based on high value. The review of strategic suppliers will add an additional dimension to our approach to supplier management but is not yet complete.	Head of Procurement	September 2011
1.02	Full implementation of agreed HR service standards should be rolled out with reports being provided to senior management on a regular basis to inform workforce planning.	In progress	Deputy Director of HR	September 2011

## Appendix D – Communications to Management

International Standards on Auditing ("ISA") (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with governance. Those charged with Governance is taken to be the Members of the Audit Committee with responsibility discharged through the regular meetings of the Audit Committee during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2010/11 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to 26 January 2011 Audit Committee and confirmed no member of audit team has any direct interest, financial or otherwise, in NHS Education for Scotland.
Audit Approach and Scope	Audit Planning document (reported to Audit Committee 26 January 2010)
Accounting Policies/Practices with a Material Effect on the Financial Statements	Sections 3 of our Annual Report to Commission Members and the Auditor General for Scotland.
Potential Effects of Material Risks and Exposures	Audit Planning document (26 January 2011).
Audit Adjustments	Section 3 of our Annual Report to Commission Members and the Auditor General for Scotland.
Material Uncertainties relating to Going Concern	None identified.
Disagreement with Management about Matters that could be Significant to the Financial Statements	Not applicable.
Expected Modifications to the Auditor's Report	No modifications identified. A true and fair opinion provided.
Letter of Representation	Signed by management 23 June 2011.
Material Weaknesses in Internal Control	Internal Controls findings reported separately in our Interim Management Letter (7 April 2011), Section 5 of our Annual Report to Commission Members and the Auditor General for Scotland.
Fraud	Discussed fraud arrangements with the Audit Committee (26 January 2011) and management throughout audit process.



Communication Required under ISA 260	Reference/Comment
Laws and Regulations	We have not identified any material breaches of laws and regulations in the period which impact on the 2010/11 Financial Statements.
Audit materiality	Audit Planning document – presented to Audit Committee in 26 January 2011.
Fair Value Measurement and Disclosure	Included in representation letter, signed by management dated 23 June 2011.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.

#### Formal Reporting to Management during 2010/11

During the year we have presented a number of formal reports to Management and the Audit Committee and produced certain outputs. Our principal outputs during 2010/11 are summarised below:

Formal Output	Timing
Audit Plan	26 January 2011
Detailed Timetable for 2010/11 Financial Audit	26 January 2011
Interim Management Letter Including Follow Up of Prior Year Recommendations	7 April 2011
Annual Report to Board Members and the Auditor General for Scotland	16 June 2011
Audit Opinions 1. True and fair value on the financial statements ✓ 2. Regularity of income and expenditure ✓ 3. Remuneration Report (sections) ✓	} Unqualified } Audit } Opinions 23 June 2011

#### **Freedom of Information Act (Scotland) 2002**

In the event that, pursuant to a request which the institution has received under the Freedom of Information Act (Scotland) 2002 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made there under (collectively, the "Legislation"), NES is required to disclose any information contained in this report, it will notify PwC promptly and will consult with PwC prior to disclosing such report. NES agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such report. If, following consultation with PwC, NES discloses any of this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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