

NHS Lothian

# Budgeting

Internal Audit Report - Final

February 2025

Level of assurance:

Design

**SUBSTANTIAL**

Effectiveness

**SUBSTANTIAL**

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## Distribution List

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## Report Status

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<b>Fieldwork performed:</b>	12 January 2026
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The matters raised in this report are only those which came to our attention during our audit and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. The report has been prepared solely for the management of the organisation and should not be quoted in whole or in part without our prior written consent. BDO LLP neither owes nor accepts any duty to any third party whether in contract or in tort and shall not be liable, in respect of any loss, damage or expense which is caused by their reliance on this report.



# Executive Summary

Level of assurance: (see appendix II for definitions)		
Design	Substantial	There is a sound system of internal control designed to achieve system objectives.
Effectiveness	Substantial	The controls that are in place are being consistently applied.

Summary of findings:			# of agreed actions
H	0		0
M	0		0
L	3	<div style="width: 100%; height: 10px; background-color: #92d050;"></div>	3
Total number of findings: 3			

### Purpose

The Budgeting Internal Audit aimed to provide assurance to management and the Audit and Risk Committee that the controls in the following areas are well designed and operating effectively:

- Governance and Oversight;
- Budget Preparation and Timetable;
- Assumptions, Forecasts, and Scenario Planning;
- Budget Approval and Communication;
- Budget Monitoring and Reporting; and
- Relationship with Scottish Government.

### Background

It was agreed as part of the 2025-26 Internal Audit Plan that Internal Audit would conduct a review of the arrangements around Budgeting at NHS Lothian.

NHS Lothian have noted that they receive limited data from the Scottish Government to perform any longer-term financial planning; they do have a five-year plan which rolls forward current year estimates to the next four years. The Scottish Government have a Medium-Term Financial Framework which is referred to by NHS Lothian.

The Scottish Government Finance Network provides a schedule of estimates that can be applied for the forthcoming financial year - these are on an advisory rather than a compulsory basis. Instead of carrying out sensitivity analysis, the Health Board sets out a risk register for their assumptions.

The Health Board's approach is to develop three interim financial plans and a final version. Only the final version is taken to Board, with the rest going through the Finance and Resources Committee. Interim plans tend to be shared in October, December and February; with the final version shared in April. Quarterly review meetings between Business Units and

Finance are used to monitor performance against the budget and efficiency targets and identify required actions. Routine updates are shared with the Scottish Government. Forecasts are updated regularly and reported on a quarterly basis.

This area was last audited in 2022 by NHS Lothians previous Internal Audit provider and resulted in significant assurance.

### Conclusion

As part of our work we have identified three findings, all of which were assessed to be of low significance.

NHS Lothian has established a Budgetary Control Procedure and an approved Scheme of Delegation to support the setting, monitoring and review of budgets, with clear accountability and defined approval thresholds for revenue and capital expenditure.

Appropriate governance arrangements are in place, including structured budget setting timetables, Finance & Resources Committee oversight, and regular monitoring through monthly dashboards and quarterly review meetings.

We did however note weaknesses in some areas of control. In particular, budget sign-offs for the 2025/26 process were not consistently evidenced in a timely manner, with incomplete signatures and date fields, and Acute Divisional Patient and e-Health approvals outstanding. We also identified scope to strengthen the budget risk register process, and that the Budget Sign-Off Tracker is not consistently updated in a way that provides independent assurance over completion across business units.

As a result of our audit, we are able to provide substantial assurance over the design and operational effectiveness of NHS Lothian's budgeting controls.



# Executive Summary

## Summary of good practice

- ▶ NHS Lothian has established a Budgetary Control Procedure to formalise delegation, monitoring, and review of budgets derived from the annual financial plan.
- ▶ The Budgetary Control Procedure and the Board-approved Scheme of Delegation formally define accountability, delegating authority from the Chief Executive to directors, budget holders, and designated approvers with clearly prescribed financial limits.
- ▶ The Budgeting Framework establishes personal accountability for budget performance, formal agreement of annual budgets, structured approval thresholds for revenue and capital expenditure, and defined processes for virement and financial governance.
- ▶ Each version of the Financial Plan is subject to defined timetable milestones, review by the Finance & Resources Committee, and formal Board approval before budgets are set, with subsequent in-year adjustments requiring Corporate Management Team oversight.
- ▶ Financial gaps are addressed through structured Financial Recovery Plans with progress monitored via monthly forecasting and quarterly oversight.
- ▶ Budget performance within NHS Lothian is monitored through monthly dashboards and quarterly review meetings, with significant variances escalated to the Finance Oversight Board for further investigation.
- ▶ Engagement with the Scottish Government occurs through regular bilateral meetings, quarterly finance reviews, and formal correspondence including three-year financial plan approval letters.

Our testing did not identify any significant concerns surrounding the controls in place to mitigate the following risks:


- ✓ Failure to maintain and effectively communicate comprehensive, up-to-date budgeting policies in line with the Scottish Public Finance Manual could lead to financial inaccuracies, regulatory non-compliance, and reputational damage for the organisation.
- ✓ Lack of clarity in roles and responsibilities can lead to miscommunication, inefficiencies, and delays in decision-making.
- ✓ Failure to establish clear, timely, and well-communicated budget preparation processes could lead to inaccurate planning, delayed approvals, and weakened financial control, ultimately jeopardising NHS Lothian's fiscal stability and service delivery.
- ✓ Lack of robust forecasting could lead to unreliable financial planning, unaddressed budget gaps, and compromised fiscal decision-making at NHS Lothian.
- ✓ Lack of consultation with budget holders could result in misaligned financial objectives, reduced engagement, and possible overspends or shortfalls, ultimately jeopardising NHS Lothian's financial control and service delivery.
- ✓ Failure to effectively monitor and report budget performance could lead to unforeseen variances, financial instability, and compromised decision-making within NHS Lothian.
- ✓ An ineffective relationship with the Scottish Government could result in NHS Lothian not receiving accurate or timely updates on baseline allocations, top-up funding, or policy changes. This in turn could lead to inaccurate budget forecasts, insufficient financial planning for changing pay and inflation rates, and limited visibility of future resource levels.

# Detailed Findings



# Detailed Findings


**Risk:** Lack of robust forecasting could lead to unreliable financial planning, unaddressed budget gaps, and compromised fiscal decision-making at NHS Lothian.

Finding 1 - Budgeting Risk Register Improvements			Type
<p>Scenario planning and sensitivity analysis are important budgeting tools as they help organisations understand how changes in key assumptions (e.g., pay awards, inflation, service pressures) could affect financial balance. These approaches strengthen financial resilience by supporting transparency around uncertainty and informing contingency planning.</p> <p>NHS Lothian has decided not to undertake formal scenario planning or sensitivity analysis as part of the budgeting process, based on prior experience that these exercises were overly complex and did not add sufficient value. Instead, NHS Lothian maintains a documented budgeting risk register which sets out the key assumptions and system pressures underpinning the Financial Plan. The register lists individual risks (e.g. winter costs, efficiency savings and cost inflation), assigns an overall risk rating, and includes narrative descriptions of the associated operational and financial impact. While this provides visibility of the principal areas of exposure, the register could be enhanced to provide a more comprehensive understanding of the risk associated with underlying assumptions. In particular, it does not routinely quantify the potential range of outcomes or clearly articulate the impact on the overall financial position should assumptions vary from plan.</p>			<p>Effectiveness</p> 
Implication			Significance
<p>While the risk register provides a useful overview of budgeting risks, there is an opportunity to enhance its structure to provide greater consistency and insight into the potential financial impact of key uncertainties.</p>			Low
Recommendations	Action owner	Management response	Completion date
<p>NHS Lothian should consider aligning its budgeting risk register more closely with good practice by enhancing risk scoring and documenting mitigating actions where feasible. Potential improvements could include separating likelihood and impact ratings, clarifying scoring definitions, including indicative financial ranges where practical, identifying mitigation and contingency actions for higher-rated risks, and assessing residual risk after management actions, recognising that quantification and mitigation may be challenging given the nature of health service delivery and external funding dependencies.</p>	<p>Claire Flanagan Head of Finance</p>	<p>We will look to enhance the Risk Register included within the Financial Plan paper or other Financial papers to incorporate likelihood and impact and financial ranges if known along with any mitigation possible.</p>	<p>Sept 2026 – for first iteration of FP 2027/28</p>



# Detailed Findings

**Risk:** Failure to establish clear, timely, and well-communicated budget preparation processes could lead to inaccurate planning, delayed approvals, and weakened financial control, ultimately jeopardising NHS Lothian’s fiscal stability and service delivery.

<b>Finding 2 - Missing Budget Sign-Off</b>			<b>Type</b>
<p>Formal budget sign-off is important to evidence that budgets have been reviewed, approved, and accepted by the appropriate responsible officer. This provides clear accountability and assurance that budget holders understand their financial responsibilities for the year.</p> <p>NHS Lothian operates a formal budget sign-off process, with budget documentation including designated sections for authorised signatures, dates, and comments. The 2025/26 budget sign-off tracker shows two outstanding approvals (8%) for Acute Divisional Management and e-Health, with letters issued in May 2025. The absent e-Health's sign-off is attributed to a change in leadership, while efforts are made to secure sign-offs promptly and staff are regularly reminded, there is limited ability to compel them to complete the process. The Acute Divisional Management is currently without budget approval because it does not function as an operational budget. Instead, it is designated for specific funding purposes, which remain unallocated until they are distributed more broadly, including allocations for Scheduled Care or ACT funding. Additionally, a further eight (31%) sign-offs were received after the 31<sup>st</sup> May 2025 deadline bringing the total budgets not received within the agreed deadline to be ten (38%).</p> <p>Within the budget sign-off tracker, the “Checked by” column within the tracker has not been populated, meaning there is no recorded evidence that the completeness and accuracy of the sign-off returns have been independently confirmed.</p>			<b>Effectiveness</b> 
<b>Implication</b>			<b>Significance</b>
<p>Incomplete sign-off documentation may reduce assurance that the budget has been formally approved, and accountability has been clearly acknowledged by the budget holder. The absence of documented checks may reduce assurance that the budget sign-off process has been fully validated and that outstanding approvals are being consistently monitored and followed up.</p>			<b>Low</b>
<b>Recommendations</b>	<b>Action owner</b>	<b>Management response</b>	<b>Completion date</b>
<p>It is recommended that NHS Lothian ensures all budget sign-off forms are fully completed, including signature and date, and that compliance with sign-off requirements is routinely monitored to evidence formal approval and accountability.</p>	<p>Claire Flanagan Head of Finance</p>	<p>To note that there was one omission from the 2025/26 sign off process due to the retiral of the relevant budget holder. For the 2026/27 budget sign off, regular update reporting will be provided at weekly Senior Finance Team (SFT) meetings to aid visibility and compliance.</p>	<p>End of June 2026</p>



## Detailed Findings


**Risk:** Failure to establish clear, timely, and well-communicated budget preparation processes could lead to inaccurate planning, delayed approvals, and weakened financial control, ultimately jeopardising NHS Lothian’s fiscal stability and service delivery.

Finding 2 - Missing Budget Sign-Off			Type
It is recommended that NHS Lothian ensures the “Checked by” field within the Budget Sign-Off Tracker is completed to evidence independent review and confirmation of budget sign-off returns. Routine monitoring of tracker completion should also be embedded to support effective oversight and accountability for the annual budget approval process.	Claire Flanagan Head of Finance	We will review the Budget Sign off Tracker and include appropriate governance and update reporting at SFT on those that have been signed off. We will also report budget sign off formally to CMT.	End of June 2026



# Detailed Findings

**Risk:** Failure to maintain and effectively communicate comprehensive, up-to-date budgeting policies in line with the Scottish Public Finance Manual could lead to financial inaccuracies, regulatory non-compliance, and reputational damage for the organisation.

Finding 3 - Out of Date Procedure			Type
<p>Maintaining up-to-date financial operating procedures is important to ensure that budgetary control arrangements remain aligned with current governance expectations, organisational structures, and national guidance. Regular review supports consistent application of controls and provides assurance that responsibilities and processes remain clear and effective.</p> <p>NHS Lothian has a documented Financial Operating Procedure for Budgetary Control which sets out delegated responsibilities, monitoring requirements, and budget holder accountability. However, the procedure is overdue for formal review, with the last scheduled review date recorded as 31 March 2023.</p>			<p>Effectiveness</p> 
Implication			Significance
<p>An out-of-date procedure may reduce assurance that budgetary control processes remain fully current, consistently applied, and reflective of evolving organisational or national requirements.</p>			Low
Recommendations	Action owner	Management response	Completion date
<p>It is recommended that NHS Lothian formally reviews and updates the Budgetary Control Procedure to ensure it remains current, incorporates relevant guidance, and continues to provide an effective framework for financial governance and accountability.</p>	<p>Claire Flanagan Head of Finance</p>	<p>A review of the Budgetary Control Procedure will be undertaken to update where required and ensure fit for purpose.</p>	<p>August 2026</p>

# Appendices



## APPENDIX I - BACKGROUND

It was agreed with management and the Audit, Risk and Assurance Committee (ARAC) as part of the 2025-26 internal audit plan that Internal Audit would undertake a review of the Budgeting processes in place within the NHS Lothian.

NHS Lothian has established a comprehensive budgeting and budgetary control framework to support effective financial governance and accountability across the organisation. Budgetary management is underpinned by a formal Budgetary Control Procedure, which sets out the delegation, monitoring, and review arrangements for budgets derived from the annual financial plan. Responsibility for financial stewardship is delegated from the Chief Executive through the Board-approved Scheme of Delegation, ensuring that directors and budget holders are clearly accountable for the management of resources within prescribed financial limits. This framework requires budget holders to undertake regular monitoring of expenditure, review performance against agreed budgets, and work with the Finance Department to implement corrective actions where necessary.

Strategic oversight is provided by the Deputy Director of Finance, with operational delivery led by the Head of Finance and supported by Senior Finance Managers and Finance Business Partners. Accountability arrangements are clearly defined, with personal responsibility for budget performance embedded through formal agreement of annual budgets, structured approval thresholds for revenue and capital expenditure, and established processes for virement and governance approvals. This ensures that financial decision-making is appropriately controlled and aligned with corporate priorities.

The annual budget is developed through a structured and iterative planning process running from September to March. NHS Lothian applies an incremental budgeting methodology, with successive versions of the Financial Plan refined through updated assumptions, efficiency requirements, and specialist input, such as medicines management contributions to drug budget modelling. Each iteration is subject to defined timetable milestones, review by the Finance & Resources Committee, and formal Board approval prior to budgets being set. Once approved, budgets are uploaded to the financial system, with any subsequent in-year adjustments requiring appropriate oversight through the Corporate Management Team. This structured approach ensures that budgets are developed transparently, reviewed rigorously, and aligned with organisational objectives.

Medium-term financial planning extends beyond the annual cycle, with NHS Lothian preparing projections over a five-year horizon using aggregated sub-national data and informed forecasting assumptions. Key modelling parameters are based on historical trends, corporate finance discussions, and professional judgement, with explicit documentation of assumptions such as pay uplifts, inflationary pressures, and cost growth in major expenditure areas. Financial risks and uncertainties are managed through a documented risk register and regular oversight discussions, ensuring that emerging pressures are captured and considered as part of the organisation's overall financial strategy.

NHS Lothian also maintains structured processes to address financial gaps through Financial Recovery Plans (FRPs), which typically target efficiency savings of around 3% in line with Scottish Government requirements. Progress against these plans is monitored through monthly forecasting and reporting, supported by quarterly financial performance review meetings with business units. These review meetings provide a mechanism for assessing budget delivery, understanding key drivers of variances, and ensuring that recovery actions remain on track. Where delivery risks emerge, escalation routes exist through the Financial Oversight Board, providing additional scrutiny and support at a corporate level.

Budget performance is monitored through a combination of monthly dashboards, routine financial reporting, and quarterly review arrangements. Significant variances and emerging financial risks are escalated through established governance structures, ensuring that senior management and the Board maintain visibility over financial performance. Regular financial updates are provided to the Finance & Resources Committee, the Corporate Management Team, and the Board, supporting corporate oversight and alignment with financial recovery and risk management strategies. In addition, NHS Lothian incorporates baseline and in-year allocations received from the Scottish Government. These allocations are subject to corporate finance review to confirm their purpose, conditions, and affordability against existing commitments. Approved allocations are reflected in the Financial Plan and uploaded to the finance system, with cumulative tracking maintained through a master allocation file to ensure reconciliation against notified resource limits. Engagement with the Scottish Government is supported through regular bilateral meetings, quarterly finance reviews, and formal correspondence, ensuring that NHS Lothian's budgeting processes remain aligned with national funding arrangements and expectations.



## Appendix II: Definitions

Level of assurance	Design of internal control framework		Operational effectiveness of controls	
	Findings from review	Design opinion	Findings from review	Effectiveness opinion
<b>Substantial</b>	Appropriate procedures and controls in place to mitigate the key risks.	There is a sound system of internal control designed to achieve system objectives.	No, or only minor, exceptions found in testing of the procedures and controls.	The controls that are in place are being consistently applied.
<b>Moderate</b>	In the main there are appropriate procedures and controls in place to mitigate the key risks reviewed albeit with some that are not fully effective.	Generally a sound system of internal control designed to achieve system objectives with some exceptions.	A small number of exceptions found in testing of the procedures and controls.	Evidence of non compliance with some controls, that may put some of the system objectives at risk.
<b>Limited</b>	A number of significant gaps identified in the procedures and controls in key areas. Where practical, efforts should be made to address in-year.	System of internal controls is weakened with system objectives at risk of not being achieved.	A number of reoccurring exceptions found in testing of the procedures and controls. Where practical, efforts should be made to address in-year.	Non-compliance with key procedures and controls places the system objectives at risk.
<b>No</b>	For all risk areas there are significant gaps in the procedures and controls. Failure to address in-year affects the quality of the organisation's overall internal control framework.	Poor system of internal control.	Due to absence of effective controls and procedures, no reliance can be placed on their operation. Failure to address in-year affects the quality of the organisation's overall internal control framework.	Non compliance and/or compliance with inadequate controls.

### Recommendation significance

<b>High</b>	A weakness where there is substantial risk of loss, fraud, impropriety, poor value for money, or failure to achieve organisational objectives. Such risk could lead to an adverse impact on the business. Remedial action must be taken urgently.
<b>Medium</b>	A weakness in control which, although not fundamental, relates to shortcomings which expose individual business systems to a less immediate level of threatening risk or poor value for money. Such a risk could impact on operational objectives and should be of concern to senior management and requires prompt specific action.
<b>Low</b>	Areas that individually have no significant impact, but where management would benefit from improved controls and/or have the opportunity to achieve greater effectiveness and/or efficiency.



## Appendix III: Terms of reference

### Extract from terms of reference

#### Purpose

The Budgeting Internal Audit aims to provide assurance to management and the Audit and Risk Committee that the controls in the following areas are well designed and operating effectively:

- Governance and Oversight;
- Budget Preparation and Timetable;
- Assumptions, Forecasts, and Scenario Planning;
- Budget Approval and Communication;
- Budget Monitoring and Reporting; and
- Relationship with Scottish Government.

#### Key risks

- Failure to maintain and effectively communicate comprehensive, up-to-date budgeting policies in line with the Scottish Public Finance Manual could lead to financial inaccuracies, regulatory non-compliance, and reputational damage for the organisation.
- Lack of clarity in roles and responsibilities can lead to miscommunication, inefficiencies, and delays in decision-making.
- Failure to establish clear, timely, and well-communicated budget preparation processes could lead to inaccurate planning, delayed approvals, and weakened financial control, ultimately jeopardising NHS Lothian's fiscal stability and service delivery.
- Lack of robust forecasting could lead to unreliable financial planning, unaddressed budget gaps, and compromised fiscal decision-making at NHS Lothian.
- Lack of consultation with budget holders could result in misaligned financial objectives, reduced engagement, and possible overspends or shortfalls, ultimately jeopardising NHS Lothian's financial control and service delivery.
- Failure to effectively monitor and report budget performance could lead to unforeseen variances, financial instability, and compromised decision-making within NHS Lothian.
- An ineffective relationship with the Scottish Government could result in NHS Lothian not receiving accurate or timely updates on baseline allocations, top-up funding, or policy changes. This in turn could lead to inaccurate budget forecasts, insufficient financial planning for changing pay and inflation rates, and limited visibility of future resource levels.

#### Exclusions

The scope of the review was limited to the areas documented under the scope and approach. All other areas are considered outside of the scope of this review. Our review does not provide assurance over all aspects of Budgeting activities.

Where sample testing was undertaken, our findings and conclusions were limited to the sample testing only. Please note that there is a risk that our findings and conclusions based on the sample may differ from the findings and conclusions we would reach if we tested the entire population from which the sample is taken.



## Appendix IV: Staff interviewed

BDO LLP appreciates the time provided by all the individuals involved in this review and would like to thank them for their assistance and cooperation.

Craig Marriot	Director of Finance	Audit Sponsor
Andrew McCreadie	Deputy Director of Finance	Key Contact
Margaret Wolfenden	Senior Finance Manager	Key Contact
Clare Flanagan	Head of Finance	Interviewee
Nick Bradbury	Chief Financial Officer - Acute	Interviewee
Andrew Mackay	Site Director for St John's Hospital and Princess Alexandra Eye Pavilion	Interviewee



## Appendix V: Limitations and Responsibilities

### Management responsibilities

The Board is responsible for determining the scope of internal audit work, and for deciding the action to be taken on the outcome of our findings from our work.

The Board is responsible for ensuring the internal audit function has:

- The support of the Company's management team.
- Direct access and freedom to report to senior management, including the Chair of the Audit Committee.
- The Board is responsible for the establishment and proper operation of a system of internal control, including proper accounting records and other management information suitable for running the Company.

Internal controls covers the whole system of controls, financial and otherwise, established by the Board in order to carry on the business of the Company in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness and accuracy of the records. The individual components of an internal control system are known as 'controls' or 'internal controls'.

The Board is responsible for risk management in the organisation, and for deciding the action to be taken on the outcome of any findings from our work. The identification of risks and the strategies put in place to deal with identified risks remain the sole responsibility of the Board.

### Limitations

The scope of the review is limited to the areas documented under Appendix II - Terms of reference. All other areas are considered outside of the scope of this review.

Our work is inherently limited by the honest representation of those interviewed as part of colleagues interviewed as part of the review. Our work and conclusion is subject to sampling risk, which means that our work may not be representative of the full population.

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Our assessment of controls is for the period specified only. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that: the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or the degree of compliance with policies and procedures may deteriorate.

**Conformance with the Global Internal Audit Standards** This engagement has been conducted in accordance with the Institute of Internal Auditors' Global Internal Audit Standards.

#### FOR MORE INFORMATION:

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