



INFRASTRUCTURE, GOVERNMENT &
HEALTHCARE

The State Hospitals Board for Scotland

Annual audit report to The State
Hospitals Board for Scotland and
the Auditor General for Scotland
2007-08

19 June 2008

AUDIT

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Notice: About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ('the Code'). This report is for the benefit of only The State Hospitals Board for Scotland and is made available to Audit Scotland (together the beneficiaries), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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Executive summary

This report summarises our work for 2007-08 and our findings in relation to our audit of the financial statements, corporate governance and performance management arrangements.

Construction of the new hospital commenced during 2007-08. The Board's aim is to complete the move into the new facilities in 2010. The total cost of the project is estimated to be around £80 million. To date management consider the progress on the redevelopment project to be satisfactory, with enabling and advanced works largely complete.

Financial statements

Following approval on 19 June 2008 we issued an audit report expressing an unqualified opinion on the financial statements for the year ended 31 March 2008 and on the regularity of transactions reflected in those financial statements.

No material adjustments have been required to the draft financial statements presented for audit.

In the light of the progress on the hospital redevelopment the carrying value of the existing buildings is impaired and accelerated depreciation of £5.3 million was recognised.

Corporate governance

We considered corporate governance arrangements as they relate to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct and arrangements for the prevention and detection of corruption, and its financial position.

The statement on internal control does not disclose any significant weaknesses in the systems of internal control and is consistent with our understanding. Internal audit concluded from their work that they *"did not identify any critical control weaknesses that were considered to be pervasive in their effects on the system of internal control"*.

There is a process to record, distribute and monitor action in response to key guidance and circulars.

We monitored the Board's involvement in NFI and concluded that arrangements to manage its obligations are satisfactory.

The Board met all three financial targets for 2007-08.

Performance management

During 2007-08 financial and non-financial performance management arrangements were further enhanced to improve the performance information used by the Board. Performance management is targeted towards the objectives agreed each year in the local development plan. For 2007-08 the local delivery plan, workforce plan, budget and capital budget were created and approved at the same time.

In late September 2007 the final addendum to the Board's outline business case was approved. On 2 October 2007 the full business case for the redevelopment was considered and approved by the Scottish Government Health Directorate's capital investment group. As a result, the Board concluded its contract with its identified preferred building contractor – Skanska – and construction work commenced.

An overarching 10 year workforce plan was developed in 2006-07 and was further updated and approved in 2007-08 to support the hospital redevelopment process. The staff governance committee has a performance management process which is linked to the local development plan objectives. Management have completed a pay modernisation benefits realisation plan which has been submitted to the Scottish Government Health Directorate.

Work is ongoing to complete the implementation of *Agenda for Change*, with the finalisation of the assimilation process dependant upon the resolution of a dispute in relation to certain nursing staff.

The Board continues to engage key stakeholders through the patient focus public involvement structures to involve patients and carers in the development and implementation of strategic and operational plans. Across the NHS the chief executive leads the regional planning initiative. Management also consider that relations with the Mental Health Tribunal and the Mental Welfare Commission for Scotland are very good.

In July 2007 the eHealth strategy, which defines and addresses the requirements of all information stakeholders of the Board, was approved. The finance system was also replaced through a consortium approach. The Board is, from April 2008, part of the National Services Scotland financial services consortium, buying in financial systems delivery, support and accounts payable functions. Investments are also being made in modern server technology, mobile and remote working and improving the resilience of the network. Management consider that this will also address IT business continuity requirements. During 2007-08 the information management and technology section experienced a period of staffing change, but during the year a new head of the section was appointed.

The Board achieved £0.9 million savings against the 2007-08 target of £0.9 million. The 2008-09 financial plan includes an efficiency savings target of £1.38 million.

Introduction

Audit framework

This year was the second of our five-year appointment by the Auditor General for Scotland as external auditors of The State Hospitals Board for Scotland ("the Board"). This report to the Board and Auditor General provides our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland's *Code of Audit Practice* ("the Code") the scope of the audit was to:

- provide an opinion on the Board's financial statements and the regularity of your transactions;
- review and report on:
 - your corporate governance arrangements as they relate to: your review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct, and prevention and detection of corruption; and your financial position
 - the Board's arrangements to achieve Best Value
 - other aspects of your arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan discussed with the Board's audit committee.

Service overview

The Board is responsible for providing assessment, treatment and care in conditions of special security for individuals with mental disorder who, because of their dangerous, violent or criminal propensities, cannot be cared for in any other setting. Services are provided for Scotland and Northern Ireland. The current change agenda is ambitious and will see services transformed in new patient accommodation, on a redeveloped site, supported by regionally based medium secure services. By 2009-10 care will only be provided for patients who need conditions of maximum security. The aim is to reduce bed occupancy to 140 by 31 March 2009.

The change agenda is informed by the requirements of the Mental Health (Care and Treatment) (Scotland) Act 2003 ("the Act"). Introduction of the Act resulted in significant implications on policy, practices, workload and staffing. The aim of the hospital redevelopment is to ensure that patients are treated in accommodation appropriate to their needs and in an environment that supports rehabilitation. Construction of the new hospital commenced during 2007-08. The aim is to move into the new hospital in 2010. The total cost of the project is estimated to be around £80 million. To date, management consider the progress on the hospital redevelopment project to be satisfactory, with enabling and advanced works largely completed.



Priorities and risks

KPMG's audit methodology is risk based. To assist in the identification of risks and ensure development of a consistent approach to the audit across bodies, Audit Scotland published a *Priorities and Risks Framework* setting out seven areas for consideration:

- service redesign and sustainability;
- partnership working;
- governance;
- financial management;
- performance management;
- people management; and
- information management.

We considered the processes and arrangements in these areas in focusing our audit effort.

Responsibilities of the Board and its auditors

External auditors do not act as a substitute for the Board's own responsibilities for putting in place proper arrangements to account for its stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through accountable officers, to make arrangements to secure Best Value.

This report is structured around the headings financial statements audit, governance arrangements and performance management arrangements.

Acknowledgement

We wish to record our appreciation of the continued co-operation and assistance extended to us by your staff.

Financial statements audit

- We have issued unqualified opinions on the financial statements.
- No material adjustments have been required to the draft financial statements presented for audit.
- In the light of the progress on the hospital redevelopment the carrying value of the existing buildings is impaired and accelerated depreciation of £5.3 million was recognised.

Reporting arrangements and timetable

Draft financial statements were available for the first day of the final audit visit on 6 May 2008. While the first draft of the financial statements required some presentational amendments, these were corrected to allow the timely completion of the audit and consideration and approval of the financial statements on 19 June 2008.

Audit opinion

Following approval on 19 June 2008 we issued an audit report expressing an unqualified opinion on the financial statements for the year ended 31 March 2008 and on the regularity of transactions reflected in those financial statements.

Hospital redevelopment

In late September 2007 the final addendum to the Board's outline business case was approved. On 2 October 2007 the full business case for the redevelopment was considered and approved by the Scottish Government Health Directorate's capital investment group. As a result, the contract with the identified preferred building contractor (Skanska) was concluded during January 2008. Over the three year period of the hospital redevelopment 90% of the existing buildings will be demolished. Advance works were completed during 2007 and the phase one building programme commenced in March 2008. The project is supported by a full business case financial model and is controlled under the PRINCE II methodology. A project board has been formed and meets every two months, with weekly commercial meetings with Skanska.

During 2007-08 management reviewed the remaining useful life of the existing hospital buildings, taking into account the phased approach of the redevelopment. In the light of the progress on the hospital redevelopment the carrying value of the existing buildings is impaired and accelerated depreciation of £5.3 million was recognised. This was fully funded by the Scottish Government Health Directorate as "annually managed expenditure" and is disclosed in the summary of resource outturn. Consequently, this impairment charge has had no impact on the Board's financial outturn for the year. We have assessed the methodology used to calculate the accelerated depreciation charge and concluded that it is reasonable and in line with the planned development schedule. Similar to our recommendation in 2006-07, given the complex nature of the hospital development and the intended phased approach for implementation, management will need to continue to keep under review the remaining useful life of the hospital as the work progresses.

Recommendation one

Capital additions during the year were £8.4 million, of which £7.2 million relates to the hospital redevelopment programme. As part of contract negotiations inflation risk was transferred fully to the contractor, capping inflation at 6.75%. As part of this agreement the contractor sought early payment of this full additional cost. A payment of approximately £1 million was made in March 2008 and is reflected in assets under construction. The final payment of £900,000 was made in April 2008.

Following the signing of the redevelopment contract, legal obligations have been conferred on the Board which could give rise to additional costs. These relate to the potential of additional liabilities arising from penalties in respect of time delays, loss and expense damages and ground condition risk. Management have assessed the likelihood of the materialisation of these additional penalties in line with applicable accounting standards, and included a provision of £394,000 within the financial statements. We have assessed the methodology adopted by management and concluded that it appears reasonable. Management will need to keep under review the potential of additional liabilities arising from penalties with regular reporting to the board.

Recommendation two

During 2007-07 the internal auditors completed three reviews in respect of the hospital redevelopment programme: review of the financial model, consideration of the approach taken to complete the Office of Government Commerce gateway review three (investment decision report) and consideration of the risks and any matters in relation to accounting for the capital redevelopment programme. We have placed reliance on these reviews.

In April 2008 the internal auditors presented a briefing paper to the audit committee summarising the key findings from their work. This concluded, subject to the information provided by management to internal audit, that:

- *Review of the financial model* – the approach taken to develop the model was reasonable and appeared to take cognisance of key relevant factors.
- *OGC gateway three review* – the gateway review was carried out in accordance with best practice guidance issued by OGC, noting that whilst it is recommended that gateway reviews are performed by independent persons outwith the project, the Scottish Government Health Directorate approved the project team to complete the review due to the unavailability of independent practitioners.
- *Consideration of risk and relevant accounting matters* – whilst a comprehensive appraisal of the integrity of the financial model was not completed, internal audit concluded that it would appear that the key risks had been identified and assessed as part of the approval of the business case.

Agenda for Change accrual

Implementation of the pay modernisation agenda, specifically *Agenda for Change*, has not progressed as expected as a result of a disagreement with staff over the assimilation arrangements in respect of E grade nurses. Management is continuing to work to resolve the outstanding issues. The accrual at 31 March 2008 relating to *Agenda for Change* was £1.7 million (2006-07; £2.9 million). This reflects payments of arrears of salary of £1.2 million and a further refinement in the measurement of the costs as more information was available.

The nature of the accrual, particularly in respect of appeals, required significant management judgement to determine the assumptions on which to base the calculation. Management's evidence to support the assumptions is based on a combination of local and national statistics available in relation to the success rate of appeals processed to date. There is a risk that final settlement of resulting from assimilation and successful appeals may be over or under the amount provided. Should this be the case, management would be required to address the matter on an in-year basis. We recommend that management ensures that progress is made to progress issues towards closure prior to preparation of the 2008-09 financial statements.

Recommendation three

Equal pay

Article 141 of the Treaty of Rome requires member states to ensure and maintain "the application of the principle that men and women should receive equal pay for equal work". This was expanded on in the Equal Pay Directive, which made it clear that all such discrimination should be eliminated from all aspects of remuneration. The NHS in Scotland has received a number of claims for backdated pay increases, arising from this requirement.

For 2006-07, we accepted that no estimate of the potential liability for these claims could be identified because of the stage of development and as a result of the inclusion of a contingent liability within the financial statements. We strongly encouraged management, working with the Scottish Government Health Directorate and other NHS boards, to resolve this matter in advance of preparation of the 2007-08 financial statements.

As at 31 March 2008, NHS bodies in Scotland had received some 12,000 claims and referred them to the NHS Central Legal Office. It is possible that these claims represent a current liability for NHS boards generally. At 31 May 2008 there were 32 grievances and 32 employment tribunal claims registered against the Board.

The Central Legal Office has co-ordinated the response to all claims and attended discussions which have taken place so far. The Central Legal Office affirms that the cases in Scotland are at too early a stage to allow any assessment of financial risk to be included in the financial statements. We note the Central Legal Office's current view of the stage the cases have reached and management should continue to work with the Scottish Government Health Directorate and other NHS boards to form a view of the potential liabilities in line with accounting standards, taking into account the progress of cases in Scotland and in England.

Recommendation four

Corporate governance

- The statement on internal control does not disclose any significant weaknesses in the systems of internal control. The content of the SIC is consistent with our understanding. Internal audit concluded that there is “adequate assurance on the adequacy and effectiveness of the system of internal control”.
- Internal audit issued their annual audit report in June 2008 and concluded that their work “did not identify any critical control weaknesses that we consider to be pervasive in their effects on the system of internal control”
- There is a formal process to record, distribute and monitor action in response to key guidance and circulars.
- The Board participated in NFI for the first time in 2007. We monitored the Board’s involvement in NFI during the course of the 2006-07 audit and concluded that satisfactory arrangements are in place for managing obligations with respect to NFI.
- The Board met all three financial targets for 2007-08.

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through its chief executive, the Board is responsible for establishing arrangements 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. The *Code* requires auditors to review and report on the corporate governance arrangements as they relate to:

- the Board’s reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

Corporate governance framework

Where the board has delegated responsibility or decision making power to a sub-committee, this is included in the terms of reference for the relevant sub-committee. There are five sub-committees – audit, staff governance, clinical governance, risk and governance and remuneration. Committee terms of reference are incorporated in the standing orders and include the committee’s objectives, membership profile, remit, meeting frequency and reporting arrangements. These terms of reference are reviewed on an annual basis.

At an operational level, the governance framework is supported by:

- standing orders that outline the roles and responsibilities of the board;
- a scheme of delegation which defines the level of responsibility delegated to committees and employees; and
- standing financial instructions that define the financial responsibilities, policies and procedures and include guidance on financial controls.

The board consists of five executive directors, including the chief executive, and six non-executive directors, including the chair. All executive directors hold qualifications and the combined experience of the non-executive directors is appropriate for the Board. None of the members of the audit committee has an accountancy qualification.

The Ethical Standards in Public Life etc. (Scotland) Act 2000 required NHS organisations to implement a code of conduct for board members, outlining their responsibilities. In line with the model code, the Board's code contains rules of conduct on:

- general conduct;
- registrations of interests;
- declaration of interests; and
- lobbying and access to members of public bodies.

We considered the Board's corporate governance arrangements and, combined with the findings of internal audit, have concluded that, the corporate governance framework has been designed and implemented appropriately.

Statement on internal control ("SIC")

The SIC for 2007-08 provides details of the processes and controls and management highlights that the organisation is committed to a process of continuous development and improvement and to developing systems in response to any relevant reviews and developments in best practice. The SIC is prepared by the director of finance, in conjunction with the other directors and internal audit, and informed by reports from internal and external audit, the risk and governance committee and the audit committee. The draft SIC was considered at the audit committee in April 2008.

Risk management

Authority for establishing and monitoring arrangements has been delegated to the risk and governance committee. The Board approved the 2006-09 risk management strategy in July 2006 and, in line with the policy, is due for revision in June 2009. The strategy includes guidance on accountability and responsibility at corporate and operational levels, the framework for identification, assessment, monitoring and reporting of risks.

Membership of the risk and governance committee comprises the hospital management team and is responsible for risk management, review of the risk register action plans, progress updates and incident reviews. The audit, clinical governance and staff governance committees receive detailed reports on the corporate risks delegated to them.

The corporate risk register is reviewed annually through a workshop approach at which board members, senior and operational management and other staff members participate.

Clinical governance

The national standards for clinical governance and risk management: achieving safe, effective, patient-focused care and services were published by NHS Quality Improvement Scotland in October 2005. The Board's framework is governed by the original clinical governance strategy developed in 2002 and updated for 2005-08.

In June 2007 management received the NHS Quality Improvement Scotland local report on clinical governance and risk management: achieving safe, effective, patient focused care and services. The report included position statements over safe and effective care and services, the health, wellbeing and care experience and assurance and accountability and did not include significant weaknesses in the arrangements.

Internal audit

We have liaised with internal audit during the year to discuss the content and timing of their work in areas where we planned to place reliance. The internal audit plan was delivered in full and the draft annual internal audit report discussed by the audit committee on 24 April 2008. The annual internal audit report was finalised during June 2008 once outstanding reports had been finalised. We placed reliance on internal audit's work in the following areas:

- statement on internal control;
- review of the financial model;
- OGC gateway three review; and
- consideration of risk and relevant accounting matters.

Internal audit have reported no 'critical' or 'high' risk recommendations, three medium risk and five low risk recommendations to which management has responded to these during the year.

Internal audit issued their finalised annual audit report in June 2008 and concluded that their work "*did not identify any critical control weaknesses that we consider to be pervasive in their effects on the system of internal control*".

Internal controls

Drawing on the work of internal audit, we carried out detailed testing in relation to both organisation-wide and key financial controls. We concluded that, with the exception of minor recommendations in our interim management letter, controls were designed appropriately and operating effectively. The recommendations were accepted by management.

IT controls often have a pervasive impact on controls at the application level. IT also poses specific risks to an organisation's internal control. In line with our audit approach, the controls over the general ledger and other IT systems are also subject to evaluation for audit purposes. In April 2008 we performed our tests of design, implementation and operating effectiveness over systems access, programme changes, programme development and computer operations. We did not identify any significant control weaknesses.

Prevention and detection of fraud and irregularity

Fraud policy

The Board has a 'theft, fraud and other financial irregularities policy and response plan' which was last updated in October 2007. The policies include fraud indicators and investigation procedures and who the responsible officers are.

National Fraud Initiative ("NFI")

In 2007-08 the Board participated in the NFI in Scotland. The Scottish Government Health Directorate and NHS Counter Fraud Services have strongly supported the involvement of health bodies in the exercise, which is undertaken as part of the audits of the participating bodies. NFI brings together data from health bodies, councils, police and fire and rescue boards, 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. Health bodies provided payroll data for the exercise. The NFI has generated significant savings for Scottish public bodies (£27 million to 2005), but if fraud or overpayments are not identified, assurances may be taken about internal arrangements for preventing and detecting fraud. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application.

The overpayments and savings identified by participating bodies in Scotland during the 2006-07 exercise is currently £9.7 million, which is likely to increase in the months ahead as bodies complete their follow up work. While NHS boards did not identify a significant part of these savings, as they are principally responsible for payroll matches, the inclusion of NHS boards was worthwhile. NHS employees were linked with several payroll irregularities, including a significant payroll fraud involving working while on sick leave at another body. NHS employees were also linked with more than 90 cases of housing benefit fraud or overpayment.

The Scottish Government Health Directorate issued guidance to all NHS boards in April 2008 to outline the requirements for data preparation and submission for inclusion in the 2008-09 NFI exercise which commences on 6 October 2008.

We monitored the Board's involvement in NFI during the course of the 2006-07 audit, and updated our understanding of the status of investigations into data matches as part of our interim audit visit in November 2007. Our responsibilities in relation to the NFI exercise include completing a questionnaire evaluating the response to NFI and sample testing of cleared matches, which was submitted to Audit Scotland in February 2008. We reviewed this and identified that management have progressed well and all data matches have been actioned. Review of the NFI online system has confirmed that this is the case.

Regularity

In accordance with our responsibilities within *the Code*, we provide an opinion on the Board's financial statements and, as required by relevant authorities, the regularity of transactions. In order to gain assurance over the regularity of expenditure we have updated our understanding over the processes in place to receive Scottish Government Health Directorate circulars, register, allocate and distribute responsibility for action points and monitor and follow up these action points. Testing of the register and monitoring process identified that management's arrangements for these circulars are effective. We have considered the specific requirements of a number of financial circulars, particularly those in relation to remuneration, and did not identify any instances of non-compliance.

Financial position

The Board achieved all three of its financial targets for 2007-08.

The outturn against the revenue resource limit of £33.987 million was a saving of £64,000 against a projected outturn of £80,000. The 2007-08 revenue resource allocation included a carried forward amount from 2006-07 of £0.9 million, which was achieved as a result of additional allocations from the Scottish Government Health Directorate and savings against budget. In line with the Board's financial plan, the carried forward amount from 2006-07 was principally used to meet elements of the hospital redevelopment expenditure incurred in 2007-08, rather than 2006-07 due to slippage in the project start date.

The 2008-09 budget is based on no planned carry forward from 2007-08 and reflects a recurring uplift of 3.15% or £1 million. Management anticipate that additional non-recurring allocations of £532,000 will be received to meet ring-fenced project costs. The 2008-09 financial plan was submitted in March 2008 and predicts a breakeven outturn after utilising non-recurrent funding of £261,000. In preparing the 2008-09 financial plan, the finance risk register was reviewed to ensure the information captured was consistent with the corporate risk register. Financial risks have been identified over revenue costs in relation to the capital development, double running costs, utilities inflation and additional employee costs as a result of pay modernisation, overtime or staff sickness and absence.

The starting point for the 2008-09 budget was to roll forward that from the previous year, making adjustments for changes in recurring and non-recurring income and expenditure. The budget-setting process is initially completed by senior finance staff, but operational managers are subsequently asked to review the planned budget and formally request any amendments.

Performance management

- During 2007-08 the Board's financial and non-financial performance management arrangements were further enhanced to improve the performance information in use. Performance management is targeted towards the objectives agreed each year in the local development plan. For 2007-08 the local delivery plan, workforce plan, budget and capital budget were created and approved at the same time.
- In late September 2007 the final addendum to the Board's outline business case was approved. On 2 October 2007 the full business case for the redevelopment was considered and approved by the Scottish Government Health Directorate's capital investment group. As a result, the Board concluded its contract with its identified preferred building contractor – Skanska – and construction work commenced.
- An overarching 10 year workforce plan was developed in 2006-07 and was further updated and approved in 2007-08 to support the hospital redevelopment process. The staff governance committee has a performance management process which is linked to the local development plan objectives. Management have completed a pay modernisation benefits realisation plan which has been submitted to the Scottish Government Health Directorate.
- Work is ongoing to complete the implementation of *Agenda for Change*, with the finalisation of the assimilation process dependant upon the resolution of a dispute in relation to certain nursing staff.
- The Board continues to engage key stakeholders through the patient focus public involvement structures to involve patients and carers in the development and implementation of strategic and operational plans. Across the NHS the chief executive leads the regional planning initiative. Management also consider that relations with the Mental Health Tribunal and the Mental Welfare Commission for Scotland are very good.
- In July 2007 the eHealth strategy, which defines and addresses the requirements of all information stakeholders of the Board, was approved. The finance system was also replaced through a consortium approach. The Board is, from April 2008, part of the National Services Scotland financial services consortium, buying in financial systems delivery, support and accounts payable functions. Investments are also being made in modern server technology, mobile and remote working and improving the resilience of the network. Management consider that this will also address IT business continuity requirements. During 2007-08 the information management and technology section was experienced a period of staffing change, but during the year a new head of the section was appointed.
- The Board achieved £0.9 million savings against the 2007-08 target of £0.9 million. The 2008-09 financial plan includes an efficiency savings target of £1.38 million.

Service sustainability

In 2007-08 the full business case hospital redevelopment plan was approved and construction works commenced. The hospital redevelopment is driven by the need to deliver mental health services in a site fit for purpose. In 2007-08 occupancy levels have continued to reduce through the discharge process. This is key to the development plans as in 2008-09 some wards will be closed in line with the redevelopment schedule. The target is to reduce hospital occupancy to 140 by 31 March 2009.

Workforce management

An overarching 10 year workforce plan was developed in 2006-07 and was further updated and approved in 2007-08, to support the hospital redevelopment process. This workforce plan supports the local delivery plan. The Board also participates in regional and national forensic workforce plans for all professional groups.

The staff governance committee has a performance management process which is linked to the local development plan objectives. This includes key performance indicators on overtime, absence and vacancies. Management have completed a pay modernisation benefits realisation plan which has been submitted to the Scottish Government Health Directorate.

Work is ongoing to complete the implementation of *Agenda for Change*, with the finalisation of the assimilation process dependant upon the resolution of a dispute in relation to certain nursing staff. The Board has received a number of requests for review. The Board is required to ensure that all employees covered by *Agenda for Change* have an agreed knowledge and skills framework ("KSF") personal development plans ("PDP") by March 2009. KSF post outlines have been developed for 117 of the required total of approximately 152 posts. The KSF linked PDP process was introduced in September 2006 and the first cycle of PDP reviews took place between October 2007 and February 2008. Management have advised that work streams for 2008-09 include completion of the remaining KSF post outlines, quality assurance and validation of all KSF post outlines, implementation of the national eKSF web-based system to enable online completion and monitoring of the PDP process, and ensuring that all employees covered by *Agenda for Change* have a KSF linked PDP in place by March 2009.

Partnership working

The Board acknowledges the importance of engaging with key stakeholders in the development of its strategic plans. It continues to engage key stakeholders through the patient focus public involvement structures involving patients and carers in the development and implementation of strategic and operational plans. In addition, the Board's work requires, and is based on, effective partnership working with the territorial NHS boards and a range of external agencies, including local authorities and the Forensic Mental Health Network.

Across the NHS the chief executive leads the regional planning initiative. This includes a framework to share expertise and support the development of best practice particularly in the establishment of the new regional medium secure facilities. Directors also have effective links and regular liaison with English special hospitals to ensure sharing of best practice. Effective international links have also been established and continue to be built upon through the chief executive who links with the International Initiative for Mental Health Leaders and the International Association of Forensic Mental Health Services.

Management also consider that relations with the Mental Health Tribunal and the Mental Welfare Commission for Scotland are very good. In addition, the Board has a close liaison with the Risk Management Authority on the development and implementation of standards, policies and procedures.

Performance management

During 2007-08 the Board's financial and non-financial performance management arrangements were further enhanced to improve performance information. This focused on ensuring that:

- definitions of measures are robust and clearly defined (using national standards where these exist);

- developing systems to report against the framework;
- redesigning performance reporting to support corporate delivery of key targets;
- designing and implementing clinical teams performance framework building on all of the above and ensuring local accessibility and ease of use;
- corporate target levels and timescales for key measures are agreed in conjunction with financial and service planning; and
- accountabilities and action plans are established to ensure that key targets can be delivered.

Performance management is targeted towards the objectives agreed each year in the local development plan and the financial budgets are developed in the same way. For 2007-08 the local delivery plan, workforce plan, budget and capital budget were created and approved at the same time. The revised performance management information was available throughout 2007-08, with regular reporting to the board.

Information management

In July 2007 the eHealth strategy, which defines and addresses the requirements of all information stakeholders, was approved. The Board identified that, from a business perspective, a key gap in its information systems was in relation to human resources. Consequently, a human resource system is being implemented and went live in March / April 2008. The finance system was also replaced through a consortium approach. The Board is, from April 2008, part of the NHS National Services Scotland financial services consortium, buying in financial systems delivery, support and accounts payable functions.

Investments are also being made in modern server technology, mobile and remote working and improving the resilience of the network. Management consider that this will also address IT business continuity requirements.

During 2007-08 the information management and technology section experienced a period of staffing change and during the year a new head of the section was appointed. This has allowed for the strengthening of information management arrangements.

Audit Scotland performance studies

Audit Scotland undertakes a programme of studies on financial management, governance and performance on behalf of the Auditor General. This programme covers topics of national importance. During 2007-08 the following reports were published in relation to the NHS:

- primary care out-of-hours services;
- overseas staff in the NHS – pre-employment checks;
- overview of Scotland's health and NHS performance in 2006-07;
- free nursing and personal care; and
- managing long term conditions.

Studies on NHS asset management, diagnostics, mental health, national general medical services contract and palliative care are in progress. Audit Scotland expect to publish the NHS overview report 2007-08, focusing on financial management, in December 2008.

Reports are received by the chief executive and distributed to relevant senior management. Where appropriate, an internal action plan will be prepared, based on Audit Scotland's summary and national conclusions, to address local weaknesses. During 2007-08 there was no evidence that the board or sub-committees have considered any of the above reports. We appreciate that a number of national reports do not directly impact the Board and its activities, but we would have expected evidence that the 2006-07 overview and overseas staff reports would have been considered.

Overseas staff in the NHS – pre-employment checks

Events in Glasgow and London in 2007 were alleged to involve overseas staff working in the NHS. Following these incidents reviews were instigated which covered the arrangements for recruiting overseas staff for work in the NHS. In Scotland the Cabinet Secretary for Health and Wellbeing also requested a review of whether pre-employment screening of overseas staff working in the NHS in Scotland was in line with guidelines set out by the Centre for Protection of National Infrastructure.

Audit Scotland carried out a review as to whether NHS boards are following their own procedures on pre-employment screening, reporting in November 2007. This review considered whether NHS boards were complying with pre-employment screening procedures for overseas staff and included testing source documentation in five NHS boards.

During our 2007-08 audit planning process we indicated that, following consideration of Audit Scotland's report by the audit committee of the Scottish Parliament, we had been requested to undertake compliance testing of records at NHS boards that were not part of the national review.

Audit Scotland reported a high level of compliance and, from a sample of 235 files across five NHS boards, there was evidence on files to demonstrate that 75% of checks were performed. Overall, the Board's files also demonstrate that 75% of checks were performed. Our work over the design, implementation and effectiveness of controls over overseas recruitment has therefore concluded that, with the exception of weaknesses in relation to overseas police checks, controls are designed appropriately and implemented. For the sampled cases no Disclosure Scotland checks were completed, but at the time the procedure to check with the Scottish Criminal Records Bureau had been completed. We reported our conclusions to the chief executive on 30 April 2008 and we understand that management have undertaken to perform Disclosure Scotland checks on all new members of staff.

Asset management

The NHS in Scotland owns assets valued at over £4 billion including land, hospitals and equipment. The way these are managed has a significant impact upon service delivery. The NHS is currently undergoing service redesign which will also have an impact on the way assets are managed. The overall aim of the study is to consider the extent to which the NHS manages its assets strategically in order to ensure they are used as efficiently and effectively as possible. The study will highlight areas of good practice and make recommendations where assets can be used more efficiently.

In accordance with Audit Scotland's request, management aim to complete the data return with information on the Board's fixed assets. It is anticipated that Audit Scotland's report will be published in the autumn of 2008.

Review of major capital projects in Scotland

Between 2002 and 2007, the Scottish Government and its agencies, non departmental public bodies and the NHS completed 43 publicly funded major (in excess of £5 million) capital projects valued at £811 million. Audit Scotland's report was published in June 2008 and highlighted the following key messages:

- in general, the achievement of cost and time targets improved significantly as projects progressed;
- early cost and time estimates at project approval stage were too optimistic for many major projects;
- cost and time performance is better after contracts are awarded, as plans are more certain and risks clearer;
- few projects have been evaluated to demonstrate that they have delivered the expected wider benefits which originally justified the investment; and
- a more strategic approach to managing capital projects could improve value for money.

Audit Scotland selected the Board's estate redevelopment in its sample and reported that the costs, timetable and quality of the project were on target. The Board was one of only two of 15 projects to achieve this result.

Best Value

In 2005-06 the Board participated in the Audit Scotland baseline review of Best Value. Three areas were assessed as 'well developed' and the following areas were assessed as 'under development': securing Best Value, commitment and leadership, sound governance arrangements, accountability, sound management of resources, responsiveness and consultation; and, sustainable development.

Management's assessment of progression in Best Value was reported to the October 2006 audit committee. This report noted that since the completion of the Best Value template in May 2006 significant progress was made with the finalisation of the local delivery plan and its associated elements and in respect of organisational development.

In October 2007 the director of finance again reported management's self assessment of progress to the audit committee. In most areas management consider the Board to be 'well developed'. The main areas outstanding were the development of a new procurement strategy, which remains ongoing, and sustainable development where management anticipate that significant benefits will be realised following the completion of the hospital redevelopment programme. In January 2008 management issued an environment and sustainable development policy statement.

2008-09 onwards

Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now, with significant amounts of development work having taken place during the last year. Using the Scottish Executive's nine best value principles as the basis for audit activity, five areas have been selected as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). Audit Scotland is currently developing a series of toolkits that auditors will be required to use from 2008-09. Completion of these toolkits will require a detailed examination of the Board's arrangements in specific areas. The focus of this work in 2008-09 will be on the use of resources, including efficiency, information management, procurement, asset management, performance management and people management. It is anticipated that national reports may be prepared by Audit Scotland and it is therefore important that the Board ensures that appropriate focus and resources are available to develop arrangements to secure Best Value.

Efficient government

The efficient government initiative is a five-year programme with the aim of tackling waste, bureaucracy and duplication in Scotland's public sector. NHS boards need to embrace the efficient government agenda and establish a clear programme for delivering efficiency savings. The Board is required to deliver savings plans that address any recurring shortfall and to meet the required 2% year on year efficient government targets (increased from 1% with effect from 2008-09). Management plan to meet the required foundation level status in 2008-09. This requires the completion of the migration to the new ledger system, including the national chart of accounts, and increased automation in the procurement processes.

In 2006-07 the Board met its overall savings target delivering £321,000 of savings, of which £260,000 related to efficient government. As part of the efficient government initiative, during 2006-07 the joint negotiating committee agreed to deliver savings of £300,000 by 2007-08. By 31 March 2007, £23,000 (full year effect £77,000) had been delivered, with the remaining savings to be delivered through other projects in 2007-08, namely implementation of a shift pattern change. Due to a dispute with staff during the year as a result of the implementation of *Agenda for Change*, these remaining elements of the savings were not realised. However, the year-end outturn position includes achievement of £931,000 of efficiency savings against a target of £926,000.

The Board's 2008-09 efficient government planned savings are £1.38 million representing the 2% national target. Two additional non-recurring efficiency targets totalling £400,000 have been introduced in order to meet spending requirements during 2008-09. The largest element of the efficiency programme is achieved as a by-product of the service redesign changes as part of the hospital redevelopment, where the women's ward will be closed and the remaining patients will be rationalised into fewer wards (in 2008-09 this amounts to £975,000).

National shared support services

During the period to January 2007 NHS Scotland has been developing proposals for shared support services in financial and related services in the form of a “hub and spoke” model. The response to the proposals, including that from the Board, was characterised by reservations over the risks inherent in the proposed scheme, the impact on staff and the deliverability of savings. The project was subsequently re-launched as the shared support services programme, involving a two-tier approach which seeks to build confidence in new ways of working, using common processes and systems, leading to a single services model based on a common finance system.

This approach involves a “foundation” level of involvement around common ledger arrangements, or a “pathfinder” approach which seeks to develop more advanced elements. NHS National Services Scotland, on behalf of the Scottish Government Health Directorate, published a paper on the shared support services programme ‘plan for the way forward’ in September 2007. This paper clearly outlines the aims and objectives of the project in the period to March 2009 and beyond.

In response, the Board has developed its strategy to become a foundation level member of the project. In April 2008 the new ledger system including the revised national chart of accounts was implemented. The director of finance and performance management is on the National Services Scotland project management group.

Appendix – action plan

Priority rating for performance improvement observations raised		
<p>Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Board or systems under consideration. The weakness may therefore give rise to loss or error.</p>	<p>Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.</p>	<p>Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.</p>

No.	Issue and performance improvement observation	Management response	Officer and due date
1	<p>During 2007-08 the Board commenced its hospital redevelopment project, following approval of the final business case by the Scottish Ministers and contract agreement with their preferred contractor, Skanska.</p> <p>Given the complex nature of the hospital development, and the intended phased approach for implementation, management will need to continue to keep under review the remaining useful life of the hospital as the work progresses, working closely with the Scottish Government Health Directorate.</p> <p><i>(Grade one)</i></p>	<p>Agreed. This will form part of the annual valuation process. Advice will continue to be sought from the Scottish Government Health Directorate.</p>	<p>Deputy Director of Finance</p> <p>31 March 2009</p>
2	<p>Following the signing of the hospital redevelopment contract, legal obligations have been conferred which could give rise to additional costs. These relate to the potential of additional liabilities arising from penalties in respect of time delays, loss and expense damages and ground condition risk.</p> <p>Management will need to keep under review the potential of additional liabilities arising from penalties with regular reporting to the board.</p> <p><i>(Grade one)</i></p>	<p>Agreed. The potential additional liabilities will be reviewed on a six-monthly basis and the associated provision will be adjusted accordingly.</p>	<p>Deputy Director of Finance</p> <p>30 September 2008</p>

No.	Issue and performance improvement observation	Management response	Officer and due date
3	<p>Implementation of the pay modernisation agenda, specifically <i>Agenda for Change</i>, has progressed during 2007-08. Management confirmed that at 31 March 2008 the assimilation to the new pay and grading structure for all staff has made limited progress, as a result of a disagreement between the Board and staff over the assimilation arrangements in respect of E grade nurses.</p> <p>We recommend that management ensures that progress is made to progress issues towards closure prior to preparation of the 2008-09 financial statements.</p> <p><i>(Grade one)</i></p>	<p>Agreed. Work is progressing and should be completed for outstanding banding claims for those affected by the current dispute by August 2008. Thereafter other assimilations and reviews will be pursued as quickly as practicable.</p>	<p>Learning & Development Director</p> <p>31 March 2009</p>
4	<p>In relation to accounting for equal pay, we note the CLO's current view of the stage the cases have reached. Management should continue to work with the Scottish Government Health Directorate and other NHS boards to form a view of the potential liabilities in line with accounting standards, taking into account the progress of cases in Scotland and in England.</p> <p><i>(Grade one)</i></p>	<p>Agreed. Liaison will continue with Scottish Government Health Directorate to ensure that liabilities can be calculated appropriately, when quantifiable.</p>	<p>Deputy Director of Finance</p> <p>31 March 2009</p>

